
Digitized by the Internet Archive
in 2022 with funding from
University of Toronto

https://archive.org/details/31761115503732

CA1
AG
·78C51

Government
Publications

13

Comprehensive Auditing — Planning for Century II

Centennial Conference Proceedings
Office of the Auditor General of Canada

Ottawa, Canada
December, 1978

LIBRARY
JUL 1979
UNIVERSITY OF TORONTO

13

CA1
AG
-78C51

Comprehensive Auditing — Planning for Century II

Centennial Conference Proceedings
Office of the Auditor General of Canada

Ottawa, Canada
December, 1978

Vous pouvez obtenir la version française
de ce compte rendu en vous adressant
à la section des Communications du
Bureau du vérificateur général,
Ottawa, Canada, K1A 0G6.

© Minister of Supply and Services Canada 1979

AUDITOR GENERAL OF CANADA VÉRIFICATEUR GÉNÉRAL DU CANADA

FOREWORD

These proceedings bring together the presentations of the speakers -- distinguished guests and colleagues -- at our Centennial Conference December 7 - 8, 1978, on the theme "Comprehensive Auditing - Planning for Century II". We hope these proceedings will make a useful contribution to the literature on public sector auditing.

The editorial team has tried to retain all the significant points and emphases of the speakers to produce an all-purpose document: neither a cumbersome full transcript, with speaker introductions and thank you's, nor an abstract, which would not satisfy the serious student of government auditing. We ask you to remember that these are edited transcripts of conference remarks and not papers written by authors primarily for publication.

Audio casette tapes of the sessions are available and edited videotapes of the proceedings will be available within the next several weeks. Details can be obtained, on request, from our Communications Section.

J.J. Macdonell

March 1979

COMPREHENSIVE AUDITING - PLANNING FOR CENTURY II

General Chairman: James J. Macdonell, F.C.A., Auditor General of Canada

CONFERENCE PROGRAM

Thursday, December 7

Page

OPENING OF THE CONFERENCE:

The Honourable James A Jerome, Q.C., M.P.
Speaker of the House of Commons — xi

OPENING ADDRESS: GOVERNMENT AUDITING - AN INTERNATIONAL REVIEW — 3

The Honourable Elmer B. Staats, Ph.D.,
Comptroller General of the United States

THE PRESENT AND FUTURE ROLE OF THE PUBLIC ACCOUNTS COMMITTEE:

INTRODUCTION — 15

The Honourable Alan A. Macnaughton,
P.C., Q.C., LL.D. (Chairman)

IN THE UNITED KINGDOM — 17

The Right Honourable Edward D.L. du Cann,
P.C., M.P., Chairman, Select Committee on Public Accounts, House of Commons, United Kingdom

IN CANADA — 25

Ron Huntington, M.P., Chairman, Standing Committee
on Public Accounts, House of Commons, Canada

IN ONTARIO — 31

Patrick Reid, M.P.P., Chairman, Standing Committee
on Public Accounts, Legislative Assembly of
Ontario

Page

MANAGING PUBLIC FUNDS AND RESOURCES:

INTRODUCTION 37
Rhéal Chatelain, C.A., Deputy Auditor General (Chairman)

AUDIT PERSPECTIVES

ORGANIZATION OF THE FINANCIAL FUNCTION 41
Raymond M. Dubois, C.A., Assistant Auditor General

IMPROVING INFORMATION FOR PARLIAMENT 45
N. Glenn Ross, F.C.A., Advisor to the Auditor General; Partner, Coopers & Lybrand

IMPROVING INTERNAL AUDITING IN GOVERNMENT 51
William A. Bradshaw, F.C.A., Advisor to the Auditor General; Partner, Touche Ross & Co.

MANAGEMENT PERSPECTIVES

OBSERVATIONS ON THE AUDITOR GENERAL'S 1978 REPORT 57
Sylvain Cloutier, C.A., Deputy Minister of Transport

VALUE FOR POLICY 61
Marshall A. Cohen, LL.M., Deputy Minister of Energy, Mines and Resources

FROM THE OFFICE OF THE COMPTROLLER GENERAL OF CANADA 65
Harry G. Rogers, B.A., Comptroller General of Canada

QUESTION PERIOD: MANAGING PUBLIC FUNDS AND RESOURCES 71

Lloyd Francis, M.P., Vice-Chairman, Standing Committee on Public Accounts, House of Commons (Chairman)

Rob Parker, M.P., Member, Standing Committee on Public Accounts, House of Commons

Lawrence S. Rosen, Ph.D., F.C.A., R.I.A., Professor, York University

William A. Wilson, Ottawa Editor, The Montreal Star

Page

Friday, December 8

DEVELOPING THE COMPREHENSIVE AUDITING APPROACH:

VALUE-FOR-MONEY AUDITING 87

Kenneth G. Belbeck, C.M.C., President, Stevenson & Kellogg; Director General, Study of Procedures in Cost Effectiveness (SPICE) 1976-78 (Chairman)

DEVELOPING VALUE-FOR-MONEY METHODOLOGY: THE STUDY OF PROCEDURES IN COST EFFECTIVENESS 93

Ronald B. Robinson, M.B.A., C.M.C., Manager, Stevenson & Kellogg; Deputy Director General, SPICE, 1976-78

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT: CANADA CUSTOMS

INTRODUCTION 105

D. Larry Meyers, C.A., P.Eng., Assistant Auditor General (Chairman)

PLANNING FOR THE COMPREHENSIVE AUDIT 109

Jean-Pierre Boisclair, C.A., Principal, Office of the Auditor General, on Executive Interchange from MacGillivray & Co.

EVALUATING CONTROL SYSTEMS 119

Patrick D. Lafferty, C.A., Partner, Coopers & Lybrand

THE AUDIT OF EFFECTIVENESS MEASUREMENT AND REPORTING 123

Alan R. Gilmore, Ph.D., Co-ordinator, Program Evaluation, Office of the Auditor General

THE EFFICIENCY ISSUE 127

Donald G. Farmar, M.A.Sc., Partner, Peat, Marwick and Partners

THE EDP COMPONENT 131

Donald A. Brown, C.A., Partner, Coopers & Lybrand

REPORTING TO PARLIAMENT 135

John J. Kelly, C.A., Principal, Office of the Auditor General

Page

CASE HISTORY OF A GOVERNMENT-WIDE VALUE-FOR-MONEY STUDY: AUDITING CAPITAL EXPENDITURES

INTRODUCTION 141

Ronald B. Robinson, M.B.A., C.M.C., Manager, Stevenson & Kellogg; Deputy Director General, SPICE, 1976-78 (Chairman)

METHOD AND CRITERIA 143

Lorne D. Almack, P.Eng., C.M.C., Partner, Price Waterhouse Associates

OFFICE BUILDINGS 147

Charles R. Lavoie, C.A., Principal, Office of the Auditor General, on Executive Interchange from Thorne Riddell & Co.

INDIAN SCHOOLS 151

Oliver Kent, M.Sc., Senior Consultant, Price Waterhouse Associates

FLOOD CONTROL 155

Ronald M. Warme, M.B.A., Principal, Office of the Auditor General

QUESTION PERIOD: VALUE-FOR-MONEY AUDITING 163

Michael H. Rayner, C.A., Assistant Auditor General (Chairman)

Carol MacIvor, Parliamentary Reporter, CBC Radio

Douglas W. Rogers, C.A., Auditor General of Alberta

Joseph G. San Miguel, Ph.D., C.P.A., Associate Professor, Harvard University

F. Norman Scott, C.A., Provincial Auditor, Province of Ontario

SUMMARY OF REMARKS BY CONFERENCE CHAIRMAN 179

James J. Macdonell, F.C.A., Auditor General of Canada

Centennial Conference
Office of the Auditor General of Canada

OPENING OF THE CONFERENCE

Ottawa, Canada
December 7, 1978



M. Bedford

James J. Macdonell,
F.C.A.,
Auditor General
of Canada,
Conference Chairman

I would like to call upon one of the very distinguished persons here. I said to him a few minutes ago that my introduction would perhaps take only a few minutes. He said "If it takes longer than 60 seconds, consider yourself under censure by Parliament". So with that admonition from my boss, I will merely say that I think that Mr. Jerome really needs no introduction to anyone in this audience here this morning. What I would say is that he, as the Speaker of the House of Commons, and Senator Macnaughton, as a former Speaker, are the only two persons present this morning who are certain of a place in the history of Canada. I now call upon the Honourable James Jerome to open our Centennial Conference. . . .



John Evans

The Honourable
James A. Jerome,
Q.C., M.P.,
Speaker of the House of
Commons

I'm delighted to have the opportunity to be with you this morning and to signal the official opening of this very important conference. I am glad to see that my admonition about short speeches works here because it certainly doesn't work in the House of Commons. As a matter of fact, I had a Member just yesterday hand me a little piece from one of the papers saying that the House of Commons would do well to take a lesson from one of the African tribes. It has been a traditional rule with them that any speech made on a formal occasion must be made standing on one foot; as soon as the second foot touches the floor, the speech is over.

I said that I was glad to be here as Speaker of the House of Commons because it stresses first of all the relationship between the Auditor General and Parliament. There are a number of officers of Parliament: the Chief Electoral

Officer, the Representation Commissioner, the Language Commissioner, the Human Rights Commissioner, and so on, but the Auditor General has the highest profile in that he is an officer appointed by Parliament and responsible to the Speaker and through the Speaker, to Parliament. This, in itself, is an indication of the independence and the importance of the Office. It would be totally inappropriate that the Auditor General should, in any way, be an appointee of government, or responsible to the government of the day. He is an officer of Parliament -- I have the honour of tabling his Report each year -- and it is a great honour for me to be associated with the Office of the Auditor General and its work in that way. I say that because those of us associated with public life and the electoral process (and there are so many represented here and in such an impressive way), are aware of the increasing demands on the time and the capability of the elected Member.

The Member and the Public Purse

I am sure that every country is engaged in a constant re-examination of the role of the elected Member, particularly as it relates to the control of the public purse. The reality is that the modern-day elected Member has great pressures on his time, including those of his constituency. We have recently recognized that by providing a constituency office for all Members. Every Member who has opened a constituency office has found that it has increased the volume of his work, the demands on his time, and his need to solve problems of the electorate whether they are of the magnitude of those examined by the Public Accounts Committee or not. Those problems are important to the electors and they are part of the responsibility of the Member. So are his duties in the House, so are his duties at public functions, so are his duties in committee meetings of the House -- the list goes on and on and on. His international contacts, another activity which we have found very valuable, are nevertheless another pressure in terms of time.

The reality is that the elected Member in our society is ill-equipped to do a meaningful job in efforts to control public spending. And yet the mood of the public, obviously, is that public spending must be controlled. I don't have to persuade anybody in this audience that the mood has been demonstrated time and time again -- recently rather dramatically in various electoral results. So the public is demanding control of government spending and if the Members cannot do it, except in a nominal way, then where do they turn for the professional and skilled support needed to do a meaningful job in examining government spending? Whatever the country and whatever the political system, increasingly the electorate turns to the professionals involved in auditing, through the role of the Auditor or Comptroller General as the title may be.

The public turns to and relies upon the annual Reports of the Auditor General as a very careful, thorough, ongoing and professional scrutiny of public spending. This activity, therefore, takes on an immense importance in terms of the ability of Parliament to function and that is something of course very dear to my heart. It is a pleasure for me to be here to emphasize that.

Through this conference, marking the 100th anniversary of the Office of the Auditor General of Canada, the people in this room are living testimony to the importance of this function, not only here but around the world -- as well, the 100th anniversary of the tabling of the first Auditor General's Report in Canada and all the developments that have gone on since that tabling. And so we welcome you here. We welcome your interest and your participation. There are very important topics on the agenda which you will examine over the next couple of days. We certainly look forward to examining the results of these discussions because all of us connected with the Canadian Parliament know that the Canadian Parliament and the Canadian taxpayer will be the ultimate beneficiary of the work you are going to do. We are grateful that you are here and I am very happy to have the opportunity to play a small part in welcoming you and officially opening the conference.

Centennial Conference
Office of the Auditor General of Canada

OPENING ADDRESS:

GOVERNMENT AUDITING: AN INTERNATIONAL REVIEW

The Honourable Elmer B. Staats, Ph.D.,
Comptroller General of the United States

Ottawa, Canada
December 7, 1978

OPENING ADDRESS: GOVERNMENT AUDITING - AN INTERNATIONAL REVIEW

Hon. Elmer B. Staats

It is especially fitting today that my remarks be placed in an international perspective. While government institutions north and south of our border differ in some respects, we share a common heritage and, most importantly, we share a common interest in improving the accountability of government institutions to the people they serve.

In Canada and the United States we have an interest -- indeed, an obligation -- to foster and strengthen the capability of auditing institutions throughout the world. Both nations have given abundant evidence that they take this obligation seriously. Canada has certainly evidenced its interest in strengthening auditing institutions beyond its own borders. With the United States and Venezuela, it sponsored the *International Journal of Government Auditing*, a trilingual publication improving communication among government auditing institutions world-wide. Even more important, Canada has provided the Chairman of the United Nations Board of Auditors for many years and has played a vital role in strengthening that Board. As its Chairman, your Auditor General raised the sights of the United Nations and found many practical ways to make the Board of Auditors play a strong and sensitive role in pointing out problems and solutions in areas where the auditor's skills can do much to strengthen the United Nations' effectiveness.

It would be tempting to concentrate on the accomplishments of the Office of the Auditor General of Canada. A centennial observance is a celebration of the past, and "the past is prologue." I was privileged to see the outline of the history of the OAG. I haven't seen the publication but I can't wait to read the chapter called "Maxwell Henderson and his Horror Stories". But since we are becoming quite familiar this year with our histories, I will resist the past and offer you my assessment of the present.

Components of Change in Government Auditing

From trends in Canada and the United States, I believe the practice of government auditing is about to enter a new era of growth. The growth I foresee is an expansion of the scope of auditing and of the influence of auditors in public decision making. In my view, there are four key components of recent changes in government auditing.

The first component involves the realization by auditors that all levels of government are accountable to the people for the efficient and effective delivery of services. Related to this is a striking change in auditing -- the recognition by auditors of the interdependence of government programs across traditional lines of demarcation. We have had to forge alliances and create an atmosphere of trust and co-operation among auditors at all levels of government.

For six years, the legislative auditors of each of your provinces have met annually to discuss common problems and concerns. The Office of the Auditor General has provided a federal presence to these meetings and has worked actively to develop programs of benefit for all Canadian government auditors. In my country, intergovernmental audit forums now meet regularly in ten different regions of the U.S. These forums provide an organized way of arranging audit collaboration and are a means of examining the audit coverage of government programs by Federal, State and local audit officials.

The second component of change has been the recognition that government auditors work most effectively when they work in conjunction with internal auditors and other government financial management officials. Since World War II, the occupant of my office has met regularly with his two main counterparts in the executive branch of government — the budget director and the treasury secretary. The meetings of this group are called the Joint Financial Management Improvement Program, and their mission is to assist and encourage government agencies in their efforts to improve government financial management. The support and endorsement of your Auditor General for the creation and the appointment of a Comptroller General in the Government of Canada reflects the same trend.

As important to government auditors as the changes in relations with other audit bodies is the new relationship between the auditor and the legislator; the third component in our changing audit environment. Whether it be the Public Accounts Committee of your Parliament, or the Government Operations Committee in our Congress, the legislature has developed an increased capability to use auditors' work in the legislative process and to see that appropriate action is taken on audit findings. Although our work is of an "oversight" or *post facto* nature in its consideration by the legislature, the challenge to auditors today is tremendous. It requires that they foresee the needs of the legislature in its decision-making process, and act promptly to meet those needs.

The fourth component, and the one with probably the most impact on auditing in North America, has come from a realization that strictly financial information is not sufficient to inform government managers and decision makers -- as well as the public -- about the achievements and failures in carrying out government programs. The various financial ratios that guide private sector managers in making financial decisions have far less relevance to government managers who must also make decisions about social welfare and human resources. In the United States, we simultaneously examine government programs for efficiency, economy and effectiveness. Here in Canada, the Wilson Committee called for a form of value-for-money auditing. Examination of the two types of audit indicates that they are much the same. Regardless of what they are called,

these types of audit represent a *comprehensive* approach, considering program outputs, that is, housing units built, educational credits subsidized, or workers employed as the determinants of success. The approach allows auditors to speak knowledgeably about the management of government programs and thus make their audit reports more useful. As soon as auditors elsewhere realize its significance, we will see even greater improvements in government performance resulting from audit work.

Many countries have not yet seen the urgent need for professional external and internal auditing in the public sector. This is unfortunate because the public sector in many countries is as large as, or larger than, the private sector. Its decisions may be even more critical in affecting the standard of living and welfare of its citizens. Recently, in an address to the Asian Organization of Supreme Audit Institutions, Dr. Luis Hidalgo, Comptroller General of Ecuador and President of the Latin-American Institute of Auditing Sciences, regretted this fact and emphasized the need for government organizations to take advantage of auditing and management techniques developed in the private sector. He said:

> "... if we look at the leading developing countries where modern management techniques are being applied in government (for example the United States or Sweden) we find that the SAI (Supreme Audit Institution) has first borrowed heavily from the experience of the private sector in utilizing professional auditors and second expanded the scope of professionally-based government audit to include aspects of evaluation of efficiency and economy and program results as well as aspects of legal compliance and financial accountability."

Challenges for Auditing in the Future

These recent trends in government auditing in North America are reliable indicators of what the future holds for our profession elsewhere. When others look at our audit groups, they can see the beginnings of what the next century holds for auditors, public and private. The changes of recent years have set in motion the currents of future auditing which will culminate in auditors providing their governments with information on how well programs are operating, and how economically and efficiently they are being carried out.

Our challenge is to bring about this evolution within the framework of international co-operation and interdependence. The enormous impact of international interdependence on government auditing world-wide provides natural incentives for the development of an international audit community. It also poses serious questions which must be resolved before the profession of government auditing can grow in the ways I have described. If we are to succeed in meeting the challenge of interdependence, we must concentrate our efforts in three areas.

International Accounting and Auditing Standards

Our first challenge is to develop uniform accounting and auditing standards. Before an international audit community can become a reality, the same standards must be adopted by all nations. The benefits in terms of better international co-operation and understanding will make the effort worthwhile. Already there are indications of the kind of co-operative benefits that can be achieved when government auditors work together across geographic lines. For example, last month I approved an agreement between the U.S. Department of Defense and the French Ministry of Defense providing for reciprocal audits of United States and French government contracts. The French government will audit U.S. government contracts placed in France, and our government -- through the Defense Contract Audit Agency -- will audit French government contracts with U.S. manufacturers.

For such co-operation to be extended to more countries it will be necessary to develop accounting and auditing standards that are accepted by those countries. Speaking from my own experience in developing our *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, I can predict that this will not be an easy task.

By the early 1970's the American Institute of Certified Public Accountants, like the Canadian Institute of Chartered Accountants, had published audit standards relating solely to audits designed for expressing opinions on financial statements. Standards were not then available for the broader governmental concerns of compliance with the law and regulations, efficiency and economy of operations, and effectiveness of programs in achieving established goals. It was logical for the General Accounting Office to fill this gap, because one of our primary missions is to keep the United States Congress advised of how well Federal departments and agencies are carrying out the policies and objectives of legislation.

Standards, Policies and Objectives

To accomplish this, we undertook the development of audit standards specifically applicable to government organizations. Our standards were developed through the efforts of a working group of representatives from my office and from the Federal executive departments and agencies having the predominant programs in the area of grants-in-aid. These standards include the American Institute's standards and procedures applicable to audits performed to express an opinion on the fairness with which an organization's financial statements present its financial position and results of operations. Our standards go beyond the attest function, however, and provide that a government audit will include three elements: financial and compliance; economy and efficiency; and program results.

Several efforts are underway to test the waters for international promulgation of accounting and auditing standards. Many of you may be familiar with the International Federation of Accountants. It has convened an international auditing standards committee, working on the problem in association with the national accounting organizations of its member nations. The United States also has initiated steps toward international accounting and financial reporting standards for multinational (or transnational) corporations. In 1976, a group of experts was appointed to consider this problem.

The group's recommendations, which have now been referred to the United Nations' Economic and Social Council, contemplate the creation of a permanent body to encourage member nations to comply with these standards. This, in turn, is intended to stimulate the passage of enforcement legislation in each country. The U.N. Secretary General does not believe such standards will be adopted voluntarily, and considers that an international agreement is necessary. Under such an agreement, each government would commit itself to take action which would make the application of the standards mandatory.

From my own experience with our standards, I also favour such legislative action. The U.S. Congress recently enacted legislation establishing offices of inspectors general in twelve major Federal departments and agencies, and requiring them to comply with our audit standards. Each inspector general is required to take appropriate steps to assure that the work performed by non-federal auditors complies with these standards. While standards must earn acceptance on their own merits, the fact that compliance with them is now legislatively mandated makes it unmistakably clear that the Congress favours the promulgation and adoption of the standards.

Until international auditing standards enjoy greater popularity and receptivity, we must respect each nation's sovereignty on this matter. At the same time, we must develop some mechanism for dialogue that will enable us to make other countries aware of the potential benefits of international standards. We must move gradually toward some commonality in this area.

Accountability of International Organizations

Our second challenge is to improve the accountability of international organizations. When we consider that the total assessments and voluntary contributions to the United Nations amounted to $2.4 billion in 1977, and that the major international financial institutions approved loans of almost $10 billion in the same year, we see that good financial management of these funds is clearly called for. The member governments of international organizations do not have the authority to audit the activities or review the internal operations of these organizations. Because of this limitation, it is in the interest of all member countries who finance the activities of international organizations to work towards improving and strengthening the financial management capabilities within them.

At the recommendation of World Bank President Robert McNamara, the Bank established an evaluation unit in 1970. The Asian Development Bank began evaluations of projects assisted by its loans in 1973. The present joint system of external audit in the United Nations was established under a 1949 General Assembly resolution and that interest continues. A recent report of the U.N. Board of Auditors highlights several current concerns with the U.N. financial management system and identifies numerous instances where:

- allotments were exceeded,
- total appropriations to individual programs were exceeded, and
- total appropriations for individual sections of the regular budget were exceeded.

Certainly, the present financial system that allows these things to occur gives cause for concern.

A U.S. delegate to the United Nations emphasized recently that the United Nations must improve its financial systems and the quality of its financial management, pointing out that it cannot afford the risk or the cost of mismanagement. I know that other delegates share this view, which is supported by a March 1977 report of the United Nations Joint Inspection Unit, which notes that each organization in the United Nations system:

> "... devotes a significant part of its resources to planning and programming and to reporting, but relatively little effort is given to determining the impact of work accomplished. Information and reporting systems produce voluminous documents at high cost, but these documents do not permit a judgment in comparison with approved plans, of the quantity of work accomplished, nor of its quality."

To help achieve the needed improvements, the General Accounting Office is planning a review to assist the U.S. delegation in identifying what can be done to improve financial management in the United Nations by strengthening audit and evaluation functions. A quote from the Auditor General of Canada's 100th annual Report to the House of Commons is equally applicable to the United Nations:

> "... I became more and more concerned -- and troubled -- by the mounting evidence of a widespread lack of due regard to economy and efficiency and of insufficient attention to systematic, well-founded evaluations of program effectiveness."

Through the years, your present Auditor General and I have worked together closely, looking for ways to improve financial management in the U.N. system. We hope to continue this close working relationship. We can all readily see how the evaluation reports of international organizations will be useful to the

management of the organizations themselves. Improved financial management and evaluation will help improve accountability to the nations who provide the bulk of the funds for international organizations. In addition, the feed-back from these audit and evaluation activities should produce better managed projects in the future, benefiting the developed and developing nations.

To illustrate the point about audit and accountability being a two-way street, with benefits flowing in both directions, I want to relate the experience of developing nations in a World Bank evaluation project. An executive director of the World Bank -- a representative of 18 developing nations -- told us that the evaluation reports of the Bank have been instrumental in creating audit and evaluation organizations in those developing countries. He said that the Bank's audit and evaluation reports are used by the member nations as guides in managing projects and in conducting reviews and that as a result, these nations have a new sense of respect for their own and the Bank's activities.

Training and Professional Development

Our third challenge involves increasing the training and professional development opportunities for government auditors and financial managers. There is a growing recognition that most developing countries do not have the government infrastructure to absorb and effectively use the resources made available to them. Since almost everyone agrees on the need to assist developing countries to improve their government financial management, our office recently decided to compile an inventory of the training provided to nationals of countries receiving development assistance. We chose to perform our initial work in Latin America, because we were familiar with the widespread interest there in improving government accounting and control over available resources, and we were aware of the efforts being made by the Latin American Institute of Auditing Sciences and others in the region to help themselves. We visited five countries and completed the fieldwork in about two months.

Our findings were not surprising. First, there is a great shortage of trained accountants, auditors and financial managers in these governments. While this shortage is caused primarily by the lack of adequate training, other factors such as the low status given to the accounting profession, low pay, and personnel problems in the civil service systems, are also causes. Priority needs to be given to upgrading the financial infrastructure. Second, the "brain drain" causes a high turnover of trainees in most projects. Third, there is a reluctance of major donors -- international organizations and the developed nations -- to mount a full-scale effort to provide the resources necessary to improve financial management in the absence of firm evidence that the recipient governments themselves are prepared to make the necessary reforms.

The training of government auditors may be the greatest challenge that we are facing today. Audit standards can be adopted; but if no audit capability exists, they will be meaningless. Continued development of government auditors by members of the International Organization of Supreme Audit

Institutions (INTOSAI) promises to bring a substantial improvement in the performance of governments. For many countries, the standards of training and professionalism adopted by supreme audit institutions become the yardstick for subnational audit institutions, internal government auditors and private accounting firms. The supreme audit institutions, by banding together to form a professional society, can stay abreast of current developments in their occupational specialty. Initiating and increasing assistance for training programs is probably the best and most direct way to help governments improve their financial management and review capabilities. One way to do this is through the convening of seminars and training courses. The next interregional seminar sponsored by INTOSAI will be in Vienna, Austria, in May 1979. By including speakers from developed nations who will share audit techniques and experiences, these seminars assist in raising the level of competence of auditors around the world.

For many years, Canada and the other Commonwealth nations have participated in auditor exchange programs and other mutual training and development. In like spirit and in an effort to help developing nations strengthen their audit institutions, I have sent letters to the heads of more than 100 supreme audit institutions around the world inviting them to nominate individuals for fellowships to work with the General Accounting Office for periods of six months to one year. By equipping the auditors with the necessary capabilities, we hope that the capacity for auditing will be improved in the developing nations.

The Challenge Ahead

As I conclude these remarks, let me return to the theme of this Centennial Conference, "Comprehensive Auditing -- Planning for Century II". First, we should seek ways to strengthen the machinery of the International Organization of Supreme Audit Institutions. This organization, which is now 25 years old, has recently adopted a new charter and has established financial arrangements which should increase its capabilities as an international organization. We can build on the seminars it has initiated and we can continue to improve the *International Journal of Government Auditing* which, as a forum for reaching the audit decision makers of the world, is unexcelled.

Second, we need to strengthen regional arrangements for co-operation among auditing institutions, building upon the initiatives already taken in Latin America, Asia and Africa. We need to work with these young organizations to strengthen training in budgeting, accounting, auditing and other aspects of financial management so essential to the infrastructure needed by developing nations. Through such organizations as the World Bank, the Inter-American Bank, the German Foundation for International Development, and the United Nations, we should provide strong centres for training and leadership. Without these we cannot ensure the skills essential for strong auditing organizations.

Third, through closer co-operation between government auditing organizations, private industry, and the public accounting profession, we should seek ways in which the public and the private sectors can learn from each other and foster the broader audit objectives inherent in the term "comprehensive auditing". There are signs that the need for this co-operation is being recognized and we should build upon that.

We need to build a stronger sense of accountability in international organizations. More and more of the world's efforts to co-operate and to assist the less developed countries will be channelled through multilateral bodies. Strong accountability systems within these bodies are essential if the objectives of these organizations are to be achieved. Attaining these goals will require hard work and dedication. The work that needs to be done to ensure the future of government auditing is self-perpetuating: that is, as we learn more about auditing, we learn more about ourselves; and as we learn more about ourselves, we find new opportunities to challenge and expand our body of knowledge.

Finally, I am optimistic about the transfer of the North American audit experience to a larger domain. You have much to offer from your 100 years of experience. I agree that "the past is prologue". I realize that we have much to learn and a long road to travel. But I am confident that there will be much good news to report 100 years from now at your bicentennial.

The Honourable Elmer B. Staats, Ph.D.

The Honourable Elmer Staats was appointed Comptroller General of the United States in 1966. He previously served as Deputy Director of the Bureau of the Budget under four Presidential administrations. Mr. Staats has been a member of numerous governmental and professional councils and advisory organizations and, since 1969, has been a member of the Board of Governors of the International Organization of Supreme Audit Institutions.



Centennial Conference
Office of the Auditor General of Canada

THE PRESENT AND FUTURE ROLE OF THE PUBLIC ACCOUNTS COMMITTEE

Ottawa, Canada
December 7, 1978

THE PRESENT AND FUTURE ROLE OF THE PUBLIC ACCOUNTS COMMITTEE: INTRODUCTION

Hon. Alan A. Macnaughton, Session Chairman

I have been asked this morning to set the stage for the three parliamentarians who will follow. Briefly, I would like to give you some of the background of the Canadian Public Accounts Committee. If I needed a text I think that I would use this one: "Control of the public purse is basic to good government". Professor Norman Ward of the University of Saskatchewan, in his book, *The Public Purse*, put it as well as anyone could. In describing the role of the Public Accounts Committee, he said:

> "on the Parliamentary side, there are two major institutions, apart from the House of Commons itself, which have dominated the history of financial control: - the Committee of Supply or committee of the whole House in which the expenditure of money is authorized in detail, and the Committee on Public Accounts which is Parliament's own auditing committee and thus becomes of significance after the appropriated money has been spent. Weaknesses in either of these devices are patently weaknesses in Parliamentary control of finance; and the same is true of the Audit Office. Parliament needs, also, three major documents which must be not only accurate but intelligible to laymen: the estimates, the public accounts, and the Auditor General's report."

In 1957, Diefenbaker came in with a small majority and had a caretaker government for a few months. But in 1958, having campaigned on the issue of reform of Parliament (I don't know why he didn't include the Senate at the time) and having made a promise to the public that if elected Prime Minister he would adopt the British system and appoint a member of the official Opposition as incoming chairman of the Public Accounts Committee, he did just that, when he was elected, and I was the victim.

That year we completed a report which alleged waste and extravagance but not fraud. The Tory majority signed it; as Liberal chairman I did, too, because the facts were there. The Liberals refused to sign it. I am glad to report that in the next four years we had four unanimous reports in a three-party House of Commons. The Public Accounts Committee also established certain concepts which are:

- the Report of the Auditor General would be examined paragraph by paragraph
- Committee recommendations made in one year should be followed up the next year
- one or two Crown corporations or agencies should be examined each year, to keep them on their toes
- Committee members should put principle ahead of their desire to protect executive departments, and
- absolutely full co-operation should be extended to the Auditor General and his staff.

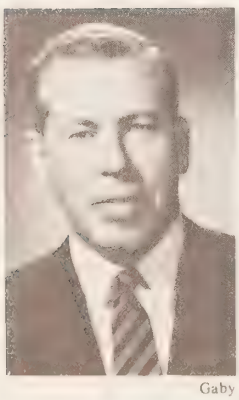
These principles are in full force and effect today. And may I say they came about through our working hard with two previous Auditors General, the late Watson Sellar and Max Henderson -- Max the Axe. Watson Sellar contributed a great deal of political experience and wisdom and was of immense aid to a new Opposition chairman of the Public Accounts Committee. Max Henderson, as you know, brought business experience, tremendous energy and several new approaches, which sometimes resulted in a great many sparks between us. But always we were working towards the same end and the end was how to be more effective. We owe a great deal to these two previous Auditors General.

I am convinced that if we have a new Auditor General Act of 1977 it is largely due to the push started by Watson Sellar, fought for by Maxwell Henderson, and brought to accomplishment by Jim Macdonell.

Before getting into the official part of this program I want to use a quotation from your 1978 Report which to me is absolutely essential:

> "The most basic issue emerging from the SPICE project and value-for-money auditing is a deceptively simple but nonetheless vital question: Why do serious managerial weaknesses continue to persist even after years of conscientious effort to overcome them?"

That, gentlemen, is your question to answer this morning.



Gaby

The Honourable Alan A. Macnaughton, P.C., Q.C., LL.D

The Honourable Alan Macnaughton is a Senator, immediate past Deputy Chairman of the Senate Banking, Trade and Commerce Committee, former Speaker of the House of Commons (1963-66) and the first member of the Opposition to be appointed Chairman of the Public Accounts Committee (1958-63). A lawyer by profession, he is Counsel to Martineau, Walker, Allison, Beaulieu, MacKell & Clermont of Montreal. Chairman of Pirelli Canada Ltd., director of several Canadian and international companies, he is also Chairman of The World Wildlife Fund of Canada and an International Trustee.

THE PRESENT AND FUTURE ROLE OF THE PUBLIC ACCOUNTS COMMITTEE: THE UNITED KINGDOM

Rt. Hon. Edward D.L. du Cann

I am very glad to talk about the present and future role of what we in the United Kingdom call the Select Committee on Public Accounts. As to the future, where perhaps all politicians are visionaries to some extent (whether our visions materialize is another matter) of course the great thing is not ever to lose hope. It was the wry comment of the late Sir Winston Churchill, that statesmanship involved a vision of the future and an ability thereafter to explain why it did not happen. We have been reading with particular interest something about the early history of your Canadian Audit Office and the recent legislative changes which took effect last year. It is clear you, too, have your visionaries in your great nation. It is a fortunate coincidence, is it not, when your visionaries are practical men also? So as I bring you greetings from the British Parliament and especially from my colleagues on the Public Accounts Committee and from the 40 nations of our great Commonwealth, I would like to sincerely offer you congratulations on the progress you are making. To us, what you are doing seems very exciting and I'm beginning to think that you, in your realism, in your toughness and especially in your determination, are setting us a splendid example.

The Committee

Now about the United Kingdom itself. The character of our Public Accounts Committee has changed greatly since the House of Commons in 1861, 117 years ago, first appointed a P.A.C. That was one of Mr. Gladstone's major reform measures -- a Liberal, but never mind that. His proposal was to examine the accounts of government departments, chiefly to ensure that parliamentary grants were used for the purposes for which they were intended.

From a present-day standpoint, the work of the Committee of the 19th century may often seem to have been concerned with matters of small compass. However, they established the basic constitutional accounting rules and standards which have formed the foundations for current, more sophisticated, control systems. The principles which they enunciated and which were accepted by the government of the day, formed the springboard for our present activities. Serious failures in departmental controls in matters of regularity and propriety are now so rare that the P.A.C. in the United Kingdom doesn't have to devote time to such things. It is thus enabled to turn to the more vital problems of eliminating waste

and extravagance; to encourage sound practices in estimating, contracting and financial administration generally; to see that government departments obtain value for money (a phrase that you use so well), and in the broadest way, to oversee the financial and administrative performance of every major department of state and many of the smaller ones.

I probably need say very little about the composition and procedures of the P.A.C. in the United Kingdom because yours have developed broadly parallel to ours. Our Committee normally has 15 members; five is the quorum. It's an all-party committee with, at present, equal numbers of Conservative and Labour MP's as members. By tradition the committee chairman is a senior member of the Opposition and has usually, like myself, held ministerial office. Now, while by convention we may examine every account laid before Parliament, we do not normally examine the nationalized industries as we call them (the state-owned industries), nor do we examine expenditure by local authorities. We concentrate on those accounts on which the Comptroller and Auditor General has reported to Parliament, and from time to time, the Committee initiates its own subjects of inquiry. But the pattern is always the same: the Comptroller and Auditor General's researches are always the foundation for our inquiries.

Spending Controls

Now I must admit, quite shamelessly and with the approbation of the House of Commons, (which is a parliamentary euphemism for the fact that nobody yet has objected) that during my own period as Chairman of the Committee, we have extended our examination to cover, in addition to particular departmental subjects, some of the widest issues of public expenditure control. I mention one of them, because I believe it to be of great concern to our Parliament, and that is the introduction of the system of cash limits covering the major part of central government expenditure. This is now about 65% of the total of what we call supply. This system was introduced for the first time two years ago, 1976-77. In essence, it is a strict cash budgetary system, intended to tighten up control of expenditure over the following year within the parameter of the government's broad forward projections. Each department has a global cash limit broken down into individual items of expenditures (the only exception to that rule is the Department of Defence, which has a single global cash limit) and I have no doubt that when sterling was going through a rough time a couple of years ago, the introduction of this system played an important part in helping to restore confidence at home and abroad.

We welcomed this system and recommended to the Treasury that Parliament should be given a closer oversight and measure of control; in particular that steps should be taken to bring the former parliamentary votes and appropriations and new departmental cash limits, as closely into line as possible. Both these recommendations were accepted by government and are now being implemented. We are now, I think, at a watershed in the matter of parliamentary control of expenditure in the United Kingdom. The Treasury and the Public Accounts Committee have been allies in that aim, and now there is the machinery for enforcing that control. The implications of a system of this sort -- which

mean that the departments have to estimate the rate of inflation forward, and have to estimate the amount required to cover pay increases during that period -- are indeed profound and if the amount of cash which each department has is limited, and Parliament says "you shall have no more under any circumstances" then the financial disciplines on the departments really become very tight. The departments must establish a better, more logical and reasonable system of priorities for the expenditure that is made. Mr. Staats put it very well when he said the past is prologue. This system is perhaps the prologue for a change and a very much tighter control in the future.

It remains to be seen whether Ministers have the strength of mind and the imagination to use this system wisely, or whether the persistent pressures on individual Members of Parliament and Ministers for heavier expenditure on a list of invariably good causes will frustrate these excellent intentions. Members of Parliament are so often staunch advocates of economies in general, but so rarely in the particular. As in Canada, in the United Kingdom the P.A.C. and the Auditor General have established, over the years, a very close working relationship much valued on both sides. But although the P.A.C. is well served by the Comptroller and Auditor General, he is not an officer of the House of Commons. He is an independent "office holder under the Crown", who reports to Parliament and only part of the work of his department comes before the Committee. Even so, the P.A.C. and the Auditor General are complementary in an important practical sense. The effectiveness of the Committee's work depends entirely on having the Comptroller and Auditor General's reports as their starting point, while the effectiveness of his scrutiny very largely depends on the fact that all his reports are considered and followed through by the Public Accounts Committee. There is therefore no limbo situation; we reinforce each other. I hope that the joint approach of the Committee and the Comptroller and Auditor General is a sophisticated and constructive one.

The aim is chiefly to look for the structural things, the important things, the trends, the control mechanisms, and so on. By tradition the Comptroller and Auditor General's reports are factual and there are sound constitutional reasons for this. In addition to summarizing the cases, his reports indicate the answers given by the department to specific questions. They don't normally make critical comment or spell out the reasons why he selected a particular case, for it is not his purpose to circumscribe the ambit of the Committee's examination or to anticipate its conclusions. His reports represent his selection and presentation of the cases which he believes provide the most suitable material available in that particular year for the Committee's purposes. And, as I said, his reports give a firm factual basis from which the Committee can proceed with its examination and conclusions.

Evidence and Investigation

Now our practice for the summoning of witnesses is particularly important, we think, to our effectiveness. Our principal witness is invariably the accounting officer for the vote under examination, normally the permanent secretary of the department. While he may bring supporting staff to give supplementary evidence on more detailed points, he is the man. The buck has to

stop somewhere, and it is the permanent secretary who is always there, in the chair, being asked the questions. The Comptroller and Auditor General attends the hearings as a witness and in the capacity as advisor to the Committee. He doesn't normally take an active part in the formal proceedings, although he often is asked to provide additional information or comment. The Treasury Officer of Accounts, a senior Treasury official, is also present and is sometimes asked to explain the part the Treasury may have played in any matters under discussion, or to give the Treasury's view on matters of general financial procedure and control. Now since the facts and the presentation in the Comptroller and Auditor General's report have been agreed with the accounting officer, the Committee can immediately start effective questioning, and concentrate on the points most worth pursuing. Our inquiries are primarily directed towards the conduct of departments, not that of outside bodies or persons. We rarely exercise our powers to summon witnesses from outside the public service, or even from closely-related sectors, such as the universities, though we have done so for special inquiries and can do so where we think fit. We don't normally examine Ministers; the last occasion when a Minister came before us was 1925.

I spoke of the first innovation, namely the widening of the range of inquiries; now to a second innovation, our procedures. Before the last parliamentary session, evidence was invariably taken before the Committee in private. Last year we admitted the public and the press to sessions where evidence was being taken on subjects not expected to raise issues of national security or commercial confidentiality. Prospective witnesses, the accounting officers, were always consulted beforehand about whether such issues were likely to arise. Where we do take evidence in private, witnesses may ask that parts of their evidence should not be published. If it is thought that the publication would be prejudicial to the public interest we agree to these requests.

I take the view that careful publicity is indispensable to the P.A.C.'s effectiveness, for even if every administration's decision was a prudent one, even if there was never a hint of waste, it is surely important that ordinary citizens should have their attention drawn, not only to the most sensational, news worthy practices of their parliamentarians -- as the media faithfully will -- but also to their painstaking work of the surveillance of expenditure. As Chairman I have made it a standing practice to hold a press conference on the publication of each Committee report. Last year we issued 12 reports covering some 61 different subjects. The Treasury, after the publication of the reports from the Public Accounts Committee, is responsible for co-ordinating the action within the executive on our reports, and for furnishing answers and comments in the form of a Treasury Minute. The P.A.C.'s reports and the relevant Treasury Minute are debated by the House of Commons each year, usually before Christmas. We are finding a considerable upsurge of public interest in these debates, perhaps because of the increasing popular concern with expenditure matters.

How Effective is the Committee?

As the scope of the audit has broadened in recent years, so has the scope of our examination. I'll give you some figures. In 1957-58, the first full financial year after I was elected to Parliament, the P.A.C. reports covered 36

pages, and had 136 paragraphs. Last year, our reports covered 152 pages and had 491 paragraphs; a four-fold increase in 20 years. The Committee, I found, has a deterrent value and that is important. The deterrent aspect of our work can strengthen the accounting officer's control at all levels in his own department. Officials are quite naturally on their guard against any course of action that might result in the head of the department appearing before the Committee to answer charges of waste or extravagance.

We know the dangers of being wise after the event, and I hope that we do examine matters in the light of the circumstances existing when the decisions were made. We don't simply seek to publicize matters which have gone wrong. I hope that we may construct the recommendations, firmly based on actual cases, which may be applied to good effect to secure future improvements in the system. We conduct our business from a national point of view, not on political party lines. I do have one regret about my own work as Chairman of the Public Accounts Committee; I am weary of inquiring into mistakes. I'm sure many civil servants in England, and I dare say here, would agree with me if I said it would be a happy development to set up a parliamentary committee to report, every now and then, on what went right.

In summary, if there are three strengths more than any others which make for the P.A.C.'s effectiveness they are: first, that we start our inquiries from the firm base of facts agreed with the accounting officer of the government department before we question him orally; second, members of the Committee work as a team, irrespective of political affiliations; and, by and large, our recommendations are accepted.

What of the Future?

I am not complacent about the Public Accounts Committee in the United Kingdom. If it is effective (and I think it is) it is effective up to a point. There is so much work waiting to be done. I mentioned in the beginning Mr. Gladstone's noble aim of bringing public expenditure under parliamentary control. In some ways, we seem to be further away from achieving that goal than we were a hundred years ago. Particularly since the end of World War II, government activities in the United Kingdom, as they have everywhere, have expanded out of all recognition compared with Mr. Gladstone's day. Governments over the years have established more and more organizations in the public sector. In the United Kingdom, new quasi-entrepreneurial bodies, such as the National Enterprise Board (a sort of large-scale merchant bank) and the National Oil Corporation are financed by public funds. The Comptroller and Auditor General does not yet have access to their books and records. There are also vast sums of monies going into private industry without Parliament having any means of checking effectively on most of this expenditure.

The faster you run the more you have to do to catch up. Fifty years ago in the United Kingdom the annual output of legislation was approximately 450 pages. Now the annual average is 3,500 pages, a seven-fold increase, and add to that 10,000 pages a year of indirect legislation, statutory instruments, and now, finally, add a mass of European legislation. The proper scrutiny of the

expenditure and activity in a growth market is a fearsome physical task, and yet it must be done. It must be given the highest priority. It will never be accomplished exclusively in a debating chamber, with all its political stresses and inhibitions. It requires a painstaking, rather than a generalist approach well-informed, pertinacious, removed from ordinary party political pressures with an adequate and well-qualified staff back-up.

So how do I see the future? There are two major parts to this question; first, how is the Public Accounts Committee going to develop its existing work? Second, what remedies do I see for the problems I've outlined? I hope I have already demonstrated the willingness that we have in the P.A.C. in London to adapt and expand our work as needs have dictated. However, there are other aspects. I mention one in particular. There is another wide and beckoning field which some national auditors have begun to enter, cautiously, namely the effectiveness of government policy. As I stated earlier, much of the value of the recommendations of the P.A.C. has stemmed from its concentration upon the administrative efficiency of government departments in carrying out a given ministerial policy. But once the audit effort is turned to an examination of whether a policy might be considered to result in an excessive expenditure of resources for the results achieved, any criticism by the P.A.C. is likely to pose a challenge to the government of the day.

Now the validity of that challenge will not normally be conceded. In the United Kingdom the Auditor General has ventured into this field in recent years in cases where considerable sums of public money were at stake and where the issues didn't appear to be heavily political. The views of the P.A.C. in such cases may not be accepted by government but their reports will draw to public attention the financal effects of certain policies -- effects which might not otherwise have been appreciated. The P.A.C. has clearly welcomed these opportunities and I don't doubt that in the future there will be further controlled ventures into this controversial work. I think that Parliament in the United Kingdom needs a much wider-ranging type of Public Accounts Committee as an instrument to monitor control of expenditure. I think this is going to happen and as it does happen some old concepts will probably come under attack, for example, the concept of ministerial responsibility. I have always thought it rather an artificial concept. But it exists and I don't doubt it will come under new examination. I also think that the individual responsibility of civil servants will be much debated.

I think we should have specialist committees in Parliament at Westminster, maybe under the general aegis of the P.A.C., to examine policy alternatives and then to report to the House thereafter, or with a continuous duty to report on the comparison of results with forecasts. The things we have to keep out of all of this work to a maximum extent -- and heaven knows it is difficult -- is the political issues. That is what we try to do.

There will always be a case for the P.A.C. doing *post facto* work or something very similar to it. But the more I see of our work, the more I feel that we are doing only a tiny fraction of what has to be done. The truth and the reality remain that in civilized countries Parliament hardly scrutinizes government's

expenditures and thus barely controls public expenditure. The inquests done by the P.A.C. are invaluable but they are hardly an exclusive recipe for a healthy, living, and effective democratic process.

The chief characteristic of a democracy, surely, is that the elected representatives of the people, back-bench Members of Parliament, should control the Executive. That's the only sanction against dictatorship, is it not? Yet year by year this task becomes harder -- the press of legislation, the power of the parties, the patronage of government -- all conspire to increase the authority of the executive. In these days of strong party disciplines, restoration of Parliament's control over the Executive is not a universally popular proposal, and yet that control is vital to an effective parliamentary democracy. If you love democracy, if you are proud to practise it, you must remember that it will never survive if you do not constantly refurbish the general confidence in its systems.

One final point; democracy is ever on trial. It is especially so today as the forces of darkness and dictatorship extend in Asia, in Africa, and still exist, 33 years after the end of World War II, even in Europe. Like love, democracy can survive all attacks except indifference or neglect. We members of Parliament are the trustees of democracy in our home nations. The challenge to us is that we should not fail those people who give us their trust. But politics is much too important to be left to the politicians. The great thing we feel in the United Kingdom is that we have a fine alliance between the politicians and the professionals, not only in the Exchequer and Audit Department but in the Departments of State. Together we are all the builders. May we succeed.

The Right Honourable Edward D.L. du Cann, P.C., M.P.



The Right Honourable Edward du Cann is Chairman of the Select Committee on Public Accounts, House of Commons, United Kingdom, and Conservative Member of Parliament for Taunton. He founded the Unicorn group of Unit Trusts in 1957 and was Chairman, Barclays Unicorn Ltd. and associated companies, 1957 to 1972. In 1971 Mr. du Cann was appointed first Chairman of the House of Commons Select Committee on Expenditure and became Chairman of the Public Accounts Committee in 1974.

THE PRESENT AND FUTURE ROLE OF THE PUBLIC ACCOUNTS COMMITTEE: CANADA

Ron Huntington

When I arrived in Ottawa as a new Member of Parliament, straight from the small business community, outraged at the careless and indifferent attitude with which my hard-earned dollar was being used, and outraged at the waste in federal government operations, I selected the Public Accounts Committee as the vehicle through which I could learn the workings of the system. I found that I had joined a small but diligent group of M.P.'s at work on the 1973 and 1974 Reports of the Auditor General. During the early P.A.C. report-writing efforts, I can remember the more senior Committee members being impatient with the annual review of matters that had been reported in previous reports. It occurred to me, as I went through the second exercise of a report, that we might be on a merry-go-round and that what we had been hearing in these past months was a calliope repeating the same old tune. In short, that nothing was really happening to or within the system.

I became aware that there was a high degree of gamesmanship involved and that efforts of the Public Accounts Committee were of minimal impact on the performance and behavioural practices that had developed within the system.

A New Challenge

Then came the Wilson report, the independent review of the Office of the Auditor General. Then the Auditor General's Financial Management and Control Study and his 1975 Report: life for Members of the Public Accounts Committee in Canada has not been the same since. At this point the concerned participant and observer had to realize that the old approach was not working; that no change was really taking place in the system, and that, if the parliamentary form of government was going to survive, a new challenge had to be met.

I recognized that if the new systems of comprehensive audit and the government-wide issue approach of the Auditor General's Office were to have any effect the Public Accounts Committee would have to rise to meet this new challenge. The Committee would have to create pressure points on a system when not only performance or behaviour was less than an acceptable standard, but also

when established practices were at variance with generally accepted accounting principles. Examples used in the Auditor General's Reports illustrated the need for fundamental change. And they were used to bring about a spirit of accountability within the system. At that point, we, on the Public Accounts Committee, set up an audit of the progress made by government departments, agencies and Crown corporations on the recommendations of the Auditor General and on the recommendations of our Committee. And we also started to increase our awareness of the issues involved, through the pre-meeting briefing sessions that I thought were so important for a proper record of the proceedings.

As our efforts in this direction improved, so did the quality of testimony within the record of proceedings. Illustrative of this point is the quality of the reports tabled in the House of Commons during the second and third sessions of the 30th Parliament. The steering committee now reviews, with the research staff, the replies to our request for progress made on the recommendations. And on the basis of the progress made by departments, agencies, and Crown corporations, invitations are sent out to appear before the Committee. The pressure on the witnesses depends entirely, in my opinion, on the pre-meeting preparation of the members. We are working very hard on this technique and have noticed the demands that this effort places on our limited research staff and on the members themselves. The 1976, 1977 and now the 1978 Reports followed, with a whole series of acronyms: FMCS, (Financial Management and Control Study), then CAISE (Computer and Information Systems Evaluation Study), SPICE, the terror of the arena now, (the Study of Procedures in Cost Effectiveness). We then had the Auditor General (not to be outdone by anybody coming in on interchange) develop a FRAME, so we've now got FRAME to deal with, which is F for financial controls, R -- reporting to Parliament, A -- attest and authority, M -- management controls and E -- electronic data processing controls. And now we have a Comptroller General who has come up with IMPAC (Improvement in Management Practices and Controls).

All of this places new demands on the Public Accounts Committee and its members. Moreover, the Auditor General and the Comptroller General have each emphasized to me the value of the P.A.C. to their own effectiveness.

Present Weaknesses

Before moving from the present to the future role of the Public Accounts Committee, I will list some of the weaknesses I see with the present Committee structure. Research staff of the Public Accounts Committee in Canada are assigned by the Library of Parliament and are understandably subject to the Library's direction. Other Members of the House and Committees have call on that research staff. However, considering the workload and the challenge facing the P.A.C. this situation can interfere with the Committee's work. The research staff from the Library and the research specialists seconded from the Auditor General's Office must remain objective and apolitical in their work. This does not always serve the interests of official Opposition members on the Committee. Mr. du Cann outlined very eloquently the need for compatibility and the lack of political antagonism needed if a P.A.C. is to achieve its objectives.

Another weakness is the technical and comprehensive nature of the issues, which often require the Committee to second highly-qualified professional people from the Auditor General's Office to assist with the writing of reports and the organization of questions in more and more complicated examinations. We have to be careful that the Committee does not become a biased forum. The P.A.C. must remain a forum where other agencies and departments can defend themselves against the allegations in the Reports of the Auditor General and it must remain a forum in which they can explain their needs to the parliamentarians.

I was interested to learn from Mr. du Cann that the membership in his Committee is 15 (I would certainly settle for 15 if I could get them all out to attend and to assist in the work of the Committee). Membership of Canada's P.A.C. is 20; membership is on the basis of seats in the House of Commons - 11 from the Government, 7 from the Official Opposition, 1 from the New Democratic Party and 1 from the Social Credit Party. The P.A.C.'s steering committee is made up of four Government members, two Official Opposition members, one NDP member and one Social Credit member. The New Democratic Party and Social Credit Party members seldom have participated through the 30th Parliament. The Official Opposition members, in my observation, carry the attacking initiative with support developing from the government side once the issue is opened up and on the record. A substantial responsibility rests with the steering committee. If the testimony is complete and the steering committee cannot agree on a point, it then comes down to a government/Public Accounts Committee clash that has to be resolved before the report can be tabled. I have to pay tribute to the members on both sides of the Committee; the reports, so far, have been unanimous which I think speaks very well for the diligence, care and attention that the P.A.C.'s hard-working nucleus has given to its responsibilities.

The P.A.C. must compete within the committee block system and I find this frustrating. Why, when we have this load of work, should we have to worry about fitting into a block system? Given the workload the P.A.C. has, priority should be given to this problem.

The P.A.C.'s Future Role and Structure

The 1978 Report of the Auditor General clearly sets out the challenge ahead. First it deals with government-wide issues: it calls for an integration of the audit processes; the implementation of systems that will improve the management and accountability process within the system; value-for-money measurement with a comment on economy and efficiency. The Auditor General can now report through his new Act on the quality of systems in place to measure effectiveness. The Auditor General says he must remain apolitical, but he is probably the most political apolitical person I have ever met! He fought the President of the Treasury Board for his Act and he fought for value-for-money concepts and he made sure that the Wilson Report recommendations came into being as a statute. From day one, he called for a chief financial officer and, lo and behold, we get a chief financial officer through a two-paragraph statute creating the Office of the Comptroller General of Canada. The importance of these two pieces of legislation is beyond description.

The new Report calls for an improvement in the quality and availability of information to Parliament. Chapter 6, I believe, is probably one of the most important chapters that we have to grapple with this year. That one in particular is going to be a challenge to bring about. It calls for a record of the criteria upon which spending decisions are based and I particularly appreciate the importance of that aspect of the report.

I have only sketched the challenge that is laid down in the Auditor General's Centennial Report. In addition, there will be cyclical comprehensive audits. I have mentioned that the other aspect of our mandate is the Public Accounts of Canada. This workload is going to crush us, if we don't start breaking it up into "chewable chunks" and that is one of the challenges we have to face in determining how the P.A.C. is going to function.

Let me just offer a few comments about the future role. There will be time available for the Public Accounts Committee to handle only the government-wide issue aspect of the Report. The cyclical comprehensive audits of departments, agencies and Crown corporations will, I think, have to be delegated to other standing or special committees with assistance being provided from a substantially fortified research arm of the Public Accounts Committee. The P.A.C.'s research staff should be permanently assigned to the Committee and should be under the direction of its Chairman. The Public Accounts Committee should continue to be able to second from the Auditor General specialists and counsel to advise when needed. But I repeat that it is essential that the Committee protect its integrity and be able to offer a jury function between the professional thrust of the Auditor General's department and the bureaucracy in the system.

Parliament, through the Speaker, should give the Committee a budget which would allow for expenses to cover investigative needs. The Official Opposition should provide an able researcher to liaise between the Public Accounts Committee's official research arm and the Committee's Official Opposition members who have a prosecutor function to perform.

The move away from the horror story approach leaves the future members of this Committee in a position of slavery, dedicated to a cause with no political rewards. I find my House of Commons activity is right down to zero, because of what I have to do in the P.A.C. There has to be an incentive for a Member of Parliament to serve as an anchor person on such an important Committee. (In my following remarks I'm not speaking for myself, because I certainly hope that my days of the Chairmanship of this Committee will be over in the very near future, and that the Chairmanship will return to the other party!) I think there has to be remuneration for the Committee's Chairman and its permanent anchor members.

Its proceedings should be televised; this will put pressure on upgrading the quality of the performance of the members in that Committee.

An Expenditure or General Estimates committee, in my opinion, should be established with similar research staff and abilities; the research office might even be common to both committees but with separate sections. Two powerful and well-disciplined committees, one at the beginning of the expenditure process and the other at the end of the spending continuum with a professional post-audit ability will, in my opinion, bring the system to heel and will put the joy of doing things well and frugally back into the minds and hearts of those that work within the system.

A strong Public Accounts Committee is essential to the success of both the Auditor General's output and the success of the Comptroller General's input, and we don't want either of them to resign. I particularly don't want this form of government, with the protection and freedom it gives, to fail. I believe that is an essential part of the challenge the P.A.C. faces.

Ron Huntington, M.P.



Ron Huntington is Chairman of the Standing Committee on Public Accounts, House of Commons, and Progressive Conservative Member for Capilano. Since his election to Parliament in 1974 he has served on several parliamentary committees and became Chairman of the Public Accounts Committee in 1977. A resident of West Vancouver, Mr. Huntington is Chairman of Service Packaging Company Limited, a West Coast packaging, processing, importing and distribution business.

THE PRESENT AND FUTURE ROLE OF THE PUBLIC ACCOUNTS COMMITTEE: ONTARIO

Patrick Reid

Let me start with what I perceive to be the present situation in parliamentary control over the Executive, particularly in terms of financial control. In Canada and in the provinces control hardly exists. A few years ago Mr. Macdonell said he had the strong feeling that spending was out of control. It's out of control, first, in terms of the review of the Estimates and second, from the point of view of the job that the Public Accounts Committee and the auditors are able to do in controlling the actions of the Executive. We have a feeling in our community of apathy and indifference because people do not believe that Parliament is controlling expenditures properly or that they are getting value for money. We have to give back to people credibility in their financial affairs and their governmental affairs. We can do that only one way and that is to make the Executive accountable and responsible for the money that is entrusted to them. But that accountability and responsibility is now lacking and we have to restore it -- and people's faith in the system.

Some Myths

I would like to examine some of the present myths, and, I hope, explode them. There is first of all the myth of ministerial responsibility. This holds that the Prime Minister or the minister of a particular department is responsible for each and every action and every dollar that is under his budget or his Estimates. That myth has survived for too many years. How can a Minister be responsible when he is administering a multi-billion-dollar budget? A few years ago when Mr. McKeough was Treasurer of Ontario, someone in his department signed a land transfer that was associated with some of Mr. McKeough's relatives. When this turned up Mr. McKeough felt it incumbent on him, as Minister with responsibility, to resign because some civil servant somewhere made a mistake. That is entirely wrong. I wonder what happened to the civil servant who signed the land transfer? There is no way that we can expect ministers to know everything and be on top of everything in their departments.

That leads me to the second myth, one I heard repeated in Ottawa last week when I brought my Public Accounts Committee down here. That is the myth that when we bring the civil servants or the representative of the department before the Public Accounts Committee, they quake in their boots; that they are

afraid to get their names in the Auditor's horror story manual and that they are afraid of what the Public Accounts Committee is going to do to them. We don't have the time to do things to those people, even if we could identify them in the first place.

In Ontario I sometimes think the civil servant manual must start off with "well, when that happened I was in another ministry" or, "I just took over this job last week and I really don't know what it is all about". What I am getting at is that civil servants should be held responsible. The Auditor General mentioned this in his report. Basically they are well paid. In Ontario, particularly at the middle management level, they are very well paid. If they foul up, we'll forgive them once -- everybody should have one chance -- but if they do it twice they should be fired, just as they would be in private enterprise. Unfortunately, what happens now leads to cynicism, even on the part of parliamentarians. As someone put it to me last week in Ottawa, government is the only place in the world where heads roll uphill.

Suggestions for the Future

Let me make what I hope are some constructive suggestions about the future. I have already said I feel it is absolutely essential that we restore the accountability of the Executive to Parliament, so that Parliament will have control over the actions of the Executive and we can convey this to the public at large. The only way to do this -- and I hope this is what the future will bring -- is through committed Public Accounts Committees and committed people on them, people who are prepared to work hard for little reward. I don't think that system is going to change very much. I think we have to have a closer relationship between the auditors and their Public Accounts Committees. Here in Ottawa, that relationship is already very close.

I think the Public Accounts Committee has to have a higher profile with the public and with the media so that people will be aware that, while there are mistakes and the system will never be perfect, at least the mistakes are being dealt with. It is not enough for us to feel that if we rake those civil servants over the coals, they won't be back next year. I have a headline here that says "Government waste repeated from earlier reports. Is anybody out there listening"? What are the follow-up procedures? One follow-up procedure must be some public redress of mistakes and that the responsible civil servant or minister must be identified -- that his head won't roll uphill.

I think we members of the Public Accounts Committee must educate ourselves and we must have the help of the auditors to do that. We must have uniform legislation across this country and we must have uniform procedures. I said before that there is a symbiotic relationship between the Public Accounts Committee and the auditor. There has to be, otherwise all that good work you are doing is wasted. But there is another symbiotic relationship that we cannot ignore if we are going to get results, and that is our relationship with the media. We have to educate the media so that they understand what we are trying to do

and take an interest in it. They usually pick out the "gold watch" -- the fifty-dollar gold watch that should have been only twenty-five, and all the rest is lost. Ladies and gentlemen, it is only with total commitment that we will restore credibility and accountability to our system.

Patrick Reid, M.P.P.



Patrick Reid is Liberal Member of the Ontario Legislature for Rainy River and Chairman of the Legislature's Public Accounts Committee. First elected in 1967 at the age of 24, Mr. Reid has been a member of several legislative committees and is currently a member of the Select Committee on Company Law and the Liberal Critic of the Ministry of Northern Affairs.

Centennial Conference
Office of the Auditor General of Canada

MANAGING PUBLIC FUNDS AND RESOURCES

Ottawa, Canada
December 7, 1978

MANAGING PUBLIC FUNDS AND RESOURCES:

INTRODUCTION

Rhéal Chatelain, Session Chairman

In his annual Report, the Auditor General suggested three pillars on which improvements in the management of government resources should rest. They are: first, an appropriate organizational structure for financial management; second, an adequate system for the presentation of financial information; and third, an integrated and co-ordinated internal audit including value for money.

From an auditor's point of view or from management's perspective, what should be the role of senior financial officers in departments and agencies of government? Is the function itself given sufficient importance? Does management recognize the necessity for leadership in financial management and control?

What is the quality and suitability of the information provided to Members of Parliament, to the government at the executive level and to public service managers? Is the information provided timely and adequate for informed decisions?

Finally, what kind of role can internal audit play in the management of public funds and resources? Should it be restricted to financial auditing? Or should it be expanded to include value-for-money aspects? Should it be comprehensive? Although the answers to these questions may be self-evident to some of us, is management fully aware of the assistance which may be provided by a strong internal audit activity, not only in the financial control of public funds but also in the economic, efficient and effective use of resources?

It will be interesting to hear whether the views of the managers really differ from those of the auditors.



Rhéal Chatelain, C.A.

Rhéal Chatelain is Deputy Auditor General, with special responsibilities for the Office's professional activities and annual program planning. Before joining the Office in 1974, Mr. Chatelain was Deputy Minister of the Public Service Department, Government of Quebec and was previously Comptroller of the Treasury and Comptroller of Finance. He is a frequent lecturer in government financial administration.

MANAGING PUBLIC FUNDS AND RESOURCES

- AUDIT PERSPECTIVES

AUDIT PERSPECTIVES: ORGANIZATION OF THE FINANCIAL FUNCTION

Raymond Dubois

I am going to speak about the organization of the financial function and its audit perspectives.

In the early 60's, Glassco suggested that the Government should let its managers manage and that it should consider a policy of decentralization. In the late 60's, the Government adopted these suggestions and at the same time emphasized the priority of service. The Canadian citizen was in future to come first. Departments were asked to extend services to all points of our vast country, a very difficult task indeed.

In 1974, the present Auditor General, still relatively new to his job, launched the Financial Management and Control Study. For the first time our Office did the audit of the financial function. We looked into departmental organizations and, in many cases, had to dig down to the fourth level to find the financial managers we were looking for. We found three types. The first were frustrated financial managers; good managers who had been boxed in. They were like tigers in a cage not knowing which way to turn. The second type were exacting bookkeepers, respectful and correct, and the third type, I am sorry to say, were the incompetent. All three were working in a context that could be described as follows: you do the accounting, let us spend the money. In general we observed that the financial community fell short of requirements in both quality and quantity.

The Auditor General was concerned and worried. We asked ourselves "What do we do in a situation like this? What can we do?" We suggested a series of recommendations, general and very polite in 1975; more precise and direct in 1976. The main weight of these recommendations was to encourage the establishment of a Comptroller General for the government and comptrollers for the departments. The President of the Treasury Board agreed with us in the House in December 1976. The Public Accounts Committee, through its report of June 1978, also demonstrated agreement.

Is Agreement Emerging?

Does this mean that everybody agreed with us? We do not think so. Departmental officials agreed on the surface and brought about theoretical

solutions, yet we still encounter deep-down resistance. For four years we have been making the same recommendations to overcome these major weaknesses. The principles of proper organization are still not totally understood and accepted. Today we ask the question again, "Is it possible to realize these objectives?" and the answer is a clear yes. Major corporations do it all the time.

We now have a Comptroller General with outstanding qualifications. He should have a major impact on the system. Some departments are using different titles, but the structures to implement our recommendations are in place and implementation is progressing encouragingly. After four years we are still asked the same questions. What are we recommending and what will this give the system? We are not talking here about a bookkeeping function. We are not after a sophisticated valet to other managers; we are after a senior manager who participates in the management process, helps other managers to fulfil their primary role, co-ordinates activities of a financial nature and pulls everything together. He is there to help improve the management process so it can attain excellence. He gives assurance to the deputy heads and he assists in keeping his department out of the Auditor General's Report.

In both our 1977 and 1978 reports, we identified three conditions that would permit the departmental comptroller to fulfil his mandate. The first is that his main and, in many cases, exclusive concern should be the financial function. The second condition is that he should report to the deputy minister and be a member of the senior management committee. The third is that he be qualified to advise the deputy minister and his colleagues in all financial matters. Let us look at one example of interaction that this comptroller could have with some of the program managers by considering a manager of a major operational system. This person must give first priority to service to his client, inside or outside the government. He does not have the time nor is it his prime interest to fully weigh the financial aspects; he is not trained for that. He cannot be an expert in everything and he needs help. The departmental comptroller responds to these needs by bringing his expertise to the service of his colleagues. He assists in preparing plans, he supplies valid data, he assists in measuring efficiency of operations and helps by pointing out potential economies. He also helps to keep the manager on track, so the Auditor General will not have to write nasty things about his operation. Although this example is simple, the human interaction within it is very complex. To establish a good relationship is a process that takes time to develop, but we are convinced that it is worth it.

Impact on the Financial Function

We now ask another question; does the value-for-money concept affect the financial function? We believe that it will enhance the importance of and emphasize the need for first class comptrollers. This is now even more crucial. In a time of monetary constraint and economic instability, we naturally put more emphasis on the real value of resources. The new mandate of the Auditor General will focus attention even more on the role of the departmental comptroller. We will tend to look more carefully at the financial function. What we began in 1974 is now an integral part of our auditing activities under comprehensive auditing. We will examine more closely in the future the interactions of the financial function to the benefit of economy and efficiency.

We found an alarming situation in 1974-75; however, the government has since made one giant step forward -- we now have a Comptroller General. Since 1975, we have observed major improvements in some departments and a beginning in others. But we are dealing with a highly complex process, filled with human problems, and there is still a great deal to do. Efforts should continue and in some areas should intensify. Because of the absolutely prime importance of the financial function, the Office of the Auditor General will continue to make such observations until that function occupies the position it should within government organizations.

Raymond M. Dubois, C.A.



Raymond Dubois is Assistant Auditor General, Departmental and Corporate Audits. Before joining the Audit Office in 1975 he was a partner, Peat, Marwick, Mitchell & Co., 1971-1975, and partner, Dubois, Ferland, St. Hilaire & Associés, 1968-1975. Mr. Dubois has participated actively in the Institute of Management Consultants of Quebec, and has served on its Council.

AUDIT PERSPECTIVES: IMPROVING INFORMATION FOR PARLIAMENT

N. Glenn Ross

My role today is to discuss the information both Parliament and management need. I believe it is the most important of the three pillars that Mr. Chatelain referred to because without adequate information comptrollers can't control, auditors can't audit, and I don't think managers can manage. I am not at all convinced, after 25 years of involvement in government, that any of these three groups now get the information they need. Worse still, I am not at all sure we are progressing very rapidly towards remedying the situation. Over the past 25 years we have had a lot of people diagnose the problem but very few actually do something about it.

In my comments today I will (1) summarize the suggestions made in 1978 for improving the information Parliament gets in the Estimates; (2) point out why information is so vital to measuring economy, efficiency and effectiveness; (3) identify some of the problems standing in the way of better information; and (4) suggest how information to Parliament can be further improved.

Suggestions from the 1978 Report

Chapter 6 of the 1978 Report, entitled "Improving the Financial Information Parliament Receives", was primarily designed to suggest how the form of the Estimates could be improved. Its objective was to provide a "shopping list" that the Public Accounts Committee could use in encouraging and assessing Treasury Board's proposals for change. Indeed it was partly designed to encourage Treasury Board to come forward with such proposals. The chapter deals with issues that auditors often encounter in dealing with departments and demonstrates how the auditor can assist the Members of Parliament to express their own opinions in an area of vital importance. It proposes some significant changes.

First, it calls for separate Estimates volumes: a summary volume that tells Parliament how the government has allocated resources to departments, and detailed volumes that tell Parliament what departments plan to do with the funds given to them.

Second, it calls for Treasury Board to impose *less* standardization, so that departments can explain their needs in a way that will make them feel accountable for the information they use in advocating their programs.

The third and fourth points call for more information to be provided on statutory programs and from Crown corporations. The reason for this is obvious when we remember that these two items now account for the majority of government expenditures.

The fifth point suggests that responsibility information should be disclosed in the Estimates. One of the myths exploded this morning was the belief that a minister can really be held accountable for everything in the Estimates. The way they are now presented shows the minister's responsibility but it does not show very clearly the responsibility of those below.

The sixth change proposed calls for Parliament to receive greater information on the activities being carried on within programs, since this is the level at which efficiency can be measured. Many of the present activities shown in the Estimates defy any efficiency disclosure.

Finally, Chapter 6 calls for selective disclosure of object-of-expenditure data, and I emphasize the word "selective". The point is that economy can be assessed basically at the input stage.

The Report points out that these proposals, which are largely technical, will have little effect unless there is one other change. Managers now feel accountable for living within the letter of the law -- to do otherwise would be to break the law, as expressed in Appropriations Acts -- but they rarely appear to feel accountable for adhering to the information they supply as advocates for their programs. The 1978 Report suggests that the government should encourage managers to recognize an obligation to account for differences between what they said they would do and what they actually did. If the government created this expectation, parliamentary accountability would automatically follow.

Information Needed to Measure Economy, Efficiency and Effectiveness

I would now like to turn to the value-for-money chapters of this year's Report, to show how they also demonstrate that good information is vital to achieving economy, efficiency and effectiveness in spending public funds.

Chapter 3 of the Report -- the economy chapter -- identifies information that one would expect to find in planning capital projects. It suggests some reasonable criteria; for example, that responsibility and accountability should be clearly defined and communicated; that requests for funds should be supported by accurate and complete documentation; and that final approval should be based on full information.

The next chapter -- the efficiency chapter -- suggests two criteria that also involve providing information; namely, the need for relevant and accurate measures of performance, and the reporting of these in reports tailored to management needs.

Chapter 5 -- the effectiveness chapter -- identifies two further information requirements; namely, that program objectives and effects be specified and that effectiveness measurement be reported.

In practice, our audits discovered that these reasonable information needs were rarely satisfied. Information was often incomplete, unreliable, or inappropriate. It often had an advocacy characteristic rather than the objectivity which, I believe, should be typical in government. I would like to point out that whereas the Estimates chapter speaks of information not available to Parliament, other chapters refer to information not available to decision-makers in government, both public servants and ministers. These are the needs. What stands in the way of better information?

The Problem and Some Solutions

The 1978 Report suggests a solution to the problem in the following words: "The natural tendency of departments to submit information that will portray them in the most favourable light needs to be restrained by tying financial figures to the official accounts and by making non-financial data as reliable as the financial amounts..." In other words, the official accounts need to be made much more useful. I sometimes feel that government auditors and accountants spend all their time preparing and auditing accounts that no one uses.

How can this sad state of affairs be remedied? The first thing we auditors, accountants and managers should push for is better data on historical expenditures. I am continually amazed that the Government of Canada seeks to introduce sophisticated new planning and evaluation techniques, all having cost data as a basis, without first ensuring that such data are available. What needs to be done then to produce better cost information in government? Let me suggest a few steps that can be taken by individual departments as well as government-wide. Some have been suggested before.

First, the government's study of the Accounts of Canada, which the government proposed, the Office of the Auditor General endorsed and the Public Accounts Committee approved, suggested that accounts payable should be set up. This is one of the starting points in producing accurate costs, since it permits cost to be produced by time periods.

A second proposal is one that was reflected in the Treasury Board's *Guide on Financial Administration* and on which little has been done. Greater use of revolving funds or open accounts within appropriations would achieve the same objective -- namely, to isolate the cost of major inventories and other deferred expenses that distort costs if expensed when acquired rather than when used.

A third suggestion is that if we want to produce cost information we should recognize that there are some costs involved in doing so. This means that systems for allocating labour and material costs should be introduced, not on a government-wide basis, but as necessary to produce reasonable data. And fourth,

the cost of those few common services not yet allocated should be allocated in some fashion as soon as possible. Now I don't think anybody from the private sector would regard any of these steps as revolutionary. There are proved techniques to implement them and their cost is reasonable.

Necessary Conditions for Action

In my opinion, little will be done until there is much more decentralization of budgetary and accounting responsibility. The centralized straight jacket that the Treasury Board imposes on departments through the form of the Estimates, and the tendency for Services Canada to produce reports tailored to its convenience rather than to departmental needs will not be removed easily and quickly. Without the co-operation of managers involved, no one at a central level can produce accurate and useful budgets and costs. Central agencies are just too far removed to obtain this information successfully.

The numerous other management information systems should also be brought under accounting control. One of the complaints I have often heard from government people is that they either have too much or too little information from many conflicting sources. Now this is not in itself bad; it is obvious that there are different types of information needs for different purposes. But what is bad is the failure to tie in the systems (systems like performance measurement systems, for example) with the official accounts so that the two can be related.

The cooks should also be brought under control. By "cooks" I mean those who cook the books and twist or manufacture figures to justify whatever they want to do. The SPICE studies this year demonstrate how figures, either carelessly or deliberately -- and it is often hard to determine which -- can be misused by program advocates if not properly challenged and tracked by comptrollers who compare estimated costs with actual costs to determine their reliability.

My last suggestion is to make those responsible for financial information also responsible for non-financial information. The key to measuring economy, efficiency and effectiveness is to marry financial figures -- the cost figures which I referred to -- with other information that identifies the inputs acquired, the work performed or the benefits realized. Since this non-financial information is harder to verify and harder to control, it is very important that it be properly compiled in the first place. Too often in government, this type of data is left to the program managers themselves, without the objective and independent scrutiny of a department's financial officers.

Reporting to Parliament

Once we have this information, what is the future need? Obviously the information can't be provided to Parliament until it is available within departments. It would be a major step forward if this information -- cost data and non-financial data to which the financial figures can be related -- were submitted to Parliament.

One of the problems today is that the Office of the Auditor General is both the value-for-money accountant and the value-for-money auditor for Parliament. Departments, not the Auditor General, should submit value-for-money data to Parliament and then his role would become the one he is traditionally used to; namely, one of looking at the adequacies of the systems, checking the information Parliament receives and telling Parliament whether it can be relied on. The recent Speech from the Throne stated that the Government will supply the results of its effectiveness evaluations to Parliament even though, as the Auditor General's Report stated this year, this is the area where the state of the art is least developed. Data to measure economy and efficiency are much easier to come by, but they are now notably absent from the Estimates and the Public Accounts. I hope that the study which the Treasury Board has now undertaken will conclude that such data should be provided in future Estimates; otherwise there will probably only be a re-ordering of figures and this will be no more useful to Parliament than the information it receives now.

The Leadership Needed

I don't think we will ever have an adequate information system unless we have properly staffed and led control functions. Objectivity will not replace advocacy as a primary characteristic of financial and other information in government until a proper control function is in operation in each department and agency.

At present, however, the rewards and sanctions in government are such that the comptroller's role is a most difficult one to play. The deterrent effect of audit disclosure, both internally and externally, may have to be relied on as a sanction that will encourage managers to heed the warnings of comptrollers and to seek their help in vetting the financial and non-financial information they submit and use, to prove that value is being obtained for the money they spend.

N. Glenn Ross, F.C.A.

Glenn Ross is a partner in the Ottawa office of Coopers & Lybrand and Advisor to the Auditor General. Mr. Ross specializes in public sector work, and he has been an advisor to the Glassco Royal Commission, the Treasury Board Secretariat and several federal and provincial government departments. He is Chairman of the Canadian Institute of Chartered Accountants' Study Group on Financial Reporting by Governments.



AUDIT PERSPECTIVES: IMPROVING INTERNAL AUDITING IN GOVERNMENT

William A. Bradshaw

My subject is internal audit. I won't argue that it's the most important pillar for improved resource management or the least important. It just happens to be the sparkplug to get the whole thing going.

As I see it, we have a two-part problem. The first part relates to value for money for the dollars spent on audit, that's the small $50 million part. The second part relates to value-for-money managing of the resources of the whole of the government. That's the big $50 billion part. Let me give you a definition of internal audit from the Institute of Internal Auditors: "An independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization". We have two inseparable problems. When internal audit does not contribute to effective management in government, we, the taxpayers, are the losers. When the resources of internal audit, the $50 million, are not managed effectively, the management of all government resources must be called into question.

The problem rests squarely on the door-steps of the deputy ministers. But that's an oversimplification. The deputy heads must take the initiative, but in a sense they are in a giant goldfish bowl and the rest of us, the Comptroller General of Canada, departmental audit committees, the Public Accounts Committee and the Auditor General, are standing on the outside. We are in a sense helpless, and yet we must recognize the power and influence we do have. There are things we can do and I will return to these in just a moment. I think it is important that we understand the problem and to do this I would like to refer briefly to some of the findings in Chapter 12 of the 1978 Auditor General's Report.

In relation to planning we found that frequently the audit effort was being directed to the areas of least importance. Grants and contribution programs, capital asset acquisition programs, large revenue programs, and computer systems were being given less attention and in some cases were totally ignored. In relation to the conduct of the audit, we found that standards were inadequate and were not being followed. We found working papers of poor quality and sometimes there were none at all. Supervision and review could have been improved in many departments. In the case of reporting (and perhaps this is the one that concerns me the most) reports were frequently issued so late that the information was absolutely useless; and limitations on the scope of the audit were often not identified, with the result that the recipient of the report was given a false sense of security. But this is not all. I think these weaknesses are part of two much more fundamental issues.

Two Fundamental Issues

The first issue is the role of the deputy head and his relationship to the internal auditor, and the second is getting a clear understanding of the benefits of audit. I would like to look first at the relationship issue. All auditing involves a three-party relationship: an auditor, a client to whom the auditor reports and the auditee -- the organization or situation being audited in which the client has an interest. The internal auditor's client is the deputy head. Just as Parliament must have trust and confidence in the Auditor General, so the deputy head must have trust and confidence in his internal auditor. In some cases we found internal auditors acting as consultants to line management, apparently ignoring their responsibility for reporting to their client, the deputy head.

Now I would like to turn to the benefit issue. I think this is probably the most simplified formula I have been able to come up with so far for measuring, or at least providing a framework for measuring benefits. The first element is the value of the information provided, to which we add the second, the conditioning or anticipatory effect of the audit. I like the word "conditioning" better than "deterrent". When any of us know that our decision may be questioned at some later date, we make that decision a little bit differently; our behaviour is affected. The third part of the formula is a potential negative, based on the false sense of security which a client may receive when the client's attention is directed exclusively to issues of minor importance. I think that if the internal auditor does a good job on number one, providing information, then it will follow that the anticipatory and conditioning benefits will be maximized and the negative results will be minimized.

As to the first part, the information provided, there are three types of reports that the internal auditor might provide to the deputy head. The first would relate to assurance on the information the deputy head is receiving for decision-making -- information relating to the environment as well as internal operations. The deputy head and the internal auditor will have to collaborate on a definition of the important decisions that the deputy head is making and the kind of information, in a general way, that he requires to make those decisions. The second kind of report would be a report on systems -- systems to control assets and revenue, to ensure economy and efficiency, and to ensure compliance. The internal auditor, when he finds weaknesses in a system, carries out what is known as substantive procedures and tries to provide evidence of waste and instances where laws and regulations have not been complied with. There is a third, an operations-type of report. This might include reporting on, for example, safety practices or security procedures. This is the role that has been defined as the eyes and ears of management. The internal auditor can learn this role by bringing operating managers into the audit team for the audit of particular sections. He can learn from working with them.

Steps to a Solution

What can be done? There are five steps that the deputy head can take. The first is to define the benefits of internal audit. This definition could then be incorporated in the audit mandate and communicated to all department employees. The second step is to be clear on the qualities and characteristics that he is looking for in his internal auditor. His conclusions should be used for hiring his auditors and evaluating internal audit performance. Step three is to negotiate a contract with his auditor -- not a written contract with big seals on it, but an oral agreement -- about what each party will do, and what each can expect from the other. Step four is to hold periodic meetings, perhaps every three months, to discuss plans and unresolved issues and problems. This might be an opportunity for the deputy head to find out if the internal auditor has sufficient resources. This would be the periodic updating of the contract. Finally, step five -- as recommended by the Institute of Internal Auditors -- the deputy head should require a self-audit by the internal auditor, to be reported to the deputy head in the same way as any other audit. I don't think this is necessarily a five-step sequential process even though I have described it as such.

Roles for Others

What can the rest of us do while the deputy head is struggling away in his fish bowl? I think the Comptroller General can do some things. He can issue standards for comprehensive audit; provide help and guidance to the deputy head in locating resources (that is a tough one); and, finally, provide a safety net or a safety line for internal auditors where there is genuine disagreement between a deputy head and an internal auditor. On this last point it must be clear that where an honest difference of opinion exists the internal auditor should be given an opportunity to work in another department. That is sometimes described as the heavy-dotted line on the organization chart.

What can departmental audit committees do? The first thing they can do is to stay out of the way. I am really concerned about departmental audit committees made up of senior departmental executives because they are in a conflict-of-interest situation, representing auditee groups rather than the client. Chapter 12 recommends including people from outside the department and representatives of the minister on audit committees, to deal with this very issue. But despite my concern, I think departmental audit committees can do some positive things. They can, in some cases, enhance the independence of the internal auditor, particularly if there are outside people on the committee. They can do some problem-solving (where the committee includes inside people) and they can assist the deputy head in the five-step process I have described.

What can the Public Accounts Committee do? The first thing it can do is to be patient and understanding -- but not in terms of the process. I think it should be very impatient in terms of the process but be patient in terms of results, because it is a big system and it is going to take some time to turn it around. And I think the Public Accounts Committee can be supportive when a deputy head takes considered risks with internal audit or in managing his department.

Finally, what can the Auditor General do to assist in this process? He can do what he has done for 100 years -- and his contribution is probably the most important one -- report to the House of Commons. When internal auditors find significant issues and report them to the deputy head, I think the Auditor General can say things are going well. Where the Auditor General finds that the big issues are being missed, not reported, then this fact will be evident to everyone from his own audit findings. And lastly, he can report on the five-step process.

Yes, we have a two-part problem. To solve it we must first understand it. The deputy heads have the key role, but the Comptroller General and departmental audit committees can provide support in the ways I have suggested. The Auditor General will monitor progress.



M. Bedford

William A. Bradshaw, F.C.A.

Bill Bradshaw is a partner in the Ottawa office of Touche Ross & Co. and Advisor to the Auditor General. From 1975 to December 1978 he was with the Office on Executive Interchange, and in the past year has been Deputy Auditor General, with special responsibilities in the area of internal audit in government. Formerly Director of Training (1967-1973) and Director of Personnel (1973-1975) of Touche Ross, Mr. Bradshaw has lectured and published extensively on professional practice issues.

MANAGING PUBLIC FUNDS AND RESOURCES

- MANAGEMENT PERSPECTIVES

MANAGEMENT PERSPECTIVES: OBSERVATIONS ON THE AUDITOR GENERAL'S 1978 REPORT

Sylvain Cloutier

I accepted the Auditor General's invitation to speak for two reasons. One is that, believe it or not, I think that Jim and I are good friends and we have been for five years. We have had our disagreements but on the whole I think we have agreed more than we have disagreed. The second reason why I wanted to accept was that, as a manager in the Public Service, I agree with his objectives and his objectives, to me, are to make financial management in the government more efficient and more effective, and indirectly improve management generally. The Auditor General asked me to give you my personal views on his annual Report, on the basis of my personal experience, and this is what I propose to do. In the process, I hope to raise some questions that I think need to be discussed over the months ahead and I say this because I would like to participate in those discussions.

The Form of the Estimates

As a Deputy Minister I'm looking forward to the discussions that the Public Accounts Committee will have on the form of the Estimates. It has been a traditional practice in the federal government, although I don't think there is a written legal requirement anywhere, that the form of both the Estimates and the Public Accounts is not changed, in any substantive way, without full discussions with the Public Accounts Committee. I look forward to those discussions because, to my knowledge, the Public Accounts Committee has not addressed this question in the last nine or ten years. I think it is important for Parliament itself to decide what it wants. For example, I remember saying to the Committee, among other things, some ten years ago: "Do you want one book or many?" We produced one book because that was what the Committee wanted. After 10 years it is not too soon to look at that subject again. I look at my own management systems much more often than that.

The Case for the Departmental Comptroller

The message that I heard earlier would lead one to believe that everybody is terrible -- you asked for my personal opinion. I have had three departments in the last nine years, and in every one of them I had a qualified departmental comptroller, who was a member of my management committee, and who reported directly to me. So I have no hangups on that, as a manager.

The Comprehensive Audit

Now we come to comprehensive audit. I am for it. Indeed, I started discussing this topic last January and I took great personal satisfaction in instituting it within my Department three weeks before your Report came in. Nearly nine years ago, in Taxation, I had a form of comprehensive audit that I called management audit and it also reported directly to me. I am happy Transport Canada was the recipient of so much attention from your Office in the last year, because now I can sympathize with my colleagues to whom you are now directing your attention. I sympathize because they will have to cope at the same time both with your comprehensive audit and Harry Roger's IMPAC study, and, as well, keep track of and act upon the maze of recommendations both of you will make to us. I sympathize with them because I see many points of similarity between these two exercises, and I wonder if collectively, we can afford that duplication because this will necessarily involve senior officials of a department, a lot of time, and I would like to think that the basic reason for my job and the jobs of my senior people is to deliver programs and administer their responsibilities.

The Auditor General is one of the parents of my friend the Comptroller General; there is no doubt about that. Perhaps I shouldn't say this, but whenever any of us becomes a parent, our personal lives, our lifestyles, change and I ask myself, should the Auditor General and his Office continue to act as though the child had not been born? Should the parent, *comme bon père de famille,* not give the child room to grow? Perhaps the time has come for the Auditor General to consider himself, perhaps, the Comptroller General's godfather, in the christian sense of the word.

Due regard to Economy and Efficiency

This concept has long been talked about and written about. The Auditor General himself admits that it is a new venue. I have no hangup about it, as a manager. But we all have to be very clear that it is definitely more than a traditional financial audit where the auditor verifies compliance with legislation, regulations, and generally accepted accounting principles. What we are now going into is really an audit of departmental management, organization, personnel and program delivery. All of these are areas where there are few, if any, regulations or even generally accepted principles against which the professional and traditional auditor, can make objective judgments. What is happening, and we should recognize this, is that the Auditor General's Office is converting itself into a management consultant and advisor. I have wondered but have no answer yet, to whom it is advisor and consultant? Is it to Parliament, or to management, or to both?

But that raises two questions. Does the makeup of the Auditor General's Office sufficiently reflect the new orientation? Is a public accounting -- and I say this as a chartered accountant -- and financial auditing background adequate for this new job? Can such a background replace technical expertise and management experience, even with the benefit of hindsight that auditors have?

My other question is: what are the limits? Is the Auditor General, in coming years, likely to recommend departmental reorganizations, the redeployment of personnel, the reallocation of resources? Will he comment on the performance of individuals? These are questions that I don't think can be left unanswered in the developmental phases of the techniques required for comprehensive audit.

I want to say a few more words about the SPICE exercise. In Transport Canada, we had 7 out of 13 major projects and the SPICE exercise really addressed the early planning stages of these seven programs. The Auditor General's observations refer to events that happened between 1970 and 1974. When I met the SPICE team at the beginning of the exercise, about fifteen months ago, I made the point that in the previous two years I had introduced substantial improvements in management control systems. I argued that it would be more helpful to me as a manager for their effort to be directed to an evaluation of the systems that I had established; or to an examination of whether my people were following my systems. But I was told that the AG's Office has powers in its law to do what it wants, so fine, go ahead. But you know, Jim, on Question Period a few weeks ago you said that you want to help managers manage. I am saying to you and your Office that I would have found it much more helpful not to go back to the things that happened when different managers were there and when the existing management control mechanisms were, of all evidence, not satisfactory enough. Indeed, I had personally improved those mechanisms after having myself found problem cases similar to those referred to in your Report. But your Report did not mention this.

The Auditor General and Government Policy

Another thing I want to raise is the stance of the Auditor General vis-à-vis government policy. As a public servant (and this is the way I expect all of my 20,000 people to act) I am bound to follow government policy directions. If in conscience, I cannot accept them, I have the alternative of quitting. In the Auditor General's Act, I see nothing that asks the AG to comment on government policy and direction, and you have recognized that. This imposes on your staff the obligation to walk a very thin line in cases where a given course of action, directed by government policy, resulted in higher costs than might have been the case if another alternative had been followed. Walking that thin line means not blaming departmental management for those extra expenditures, not taking a potshot at the policy or direction, even indirectly. Walking that thin line requires more than a yes or no judgment, in particular with regard to "due regard to economy and efficiency". I note that, out of the seven SPICE projects, five cases were judged to be ones where due regard had not been taken. I was puzzled that, on the other two, you did not say that whoever was in charge had taken due regard. Your observation was that your reviews -- I forget the exact words, but something like -- "failed to uncover serious deficiencies".

Walking this thin line requires giving consideration to the circumstances and the environment in which the decisions were made, and giving consideration to more than the documentary audit trail that is so precious to the professional auditor. Walking that thin line, in my view, requires the professional auditor to acquire not only the skills of the manager, and the management consultant, but also those of the political scientist.



John Evans

Sylvain Cloutier, C.A.

Sylvain Cloutier is Deputy Minister of Transport and the 1977 winner of the Outstanding Achievement Award of the Public Service of Canada. A former Deputy Secretary of the Treasury Board, Mr. Cloutier has also been Deputy Minister of Taxation and National Defence and has served on many boards and councils in the public sector.

MANAGEMENT PERSPECTIVES: VALUE FOR POLICY

Marshall A. Cohen

I would like to concentrate my remarks on a narrow aspect of this whole problem, given that I don't bring to bear in this discussion the years of experience of my colleague, Sylvain, as a professional manager and administrator. It seems to me that much of the focus surrounding the Auditor General's Report has been on the principle of value for money. I would like to explore what I consider to be an equally important objective; I call it value for policy. I fear that we are becoming enmeshed in what I would call the "republic of audit". That is a phrase I have stolen from Senator Lamontagne who wrote some years ago about science policy. The Senator said: "this approach (that is 'the republic of science') suggests that the scientist should be free to select his research projects and should receive the funds to carry them out, provided that they have been found by his peers (other scientists) to have scientific merit. In other words, this doctrine holds that the scientific community or, in the economist's language, the suppliers of research, should determine the level and distribution of scientific activities, thus applying to science a classical law of markets, that supply creates its own demand". I leave it to you to draw whatever analogies you wish between the republic of science and the republic of audit.

I do accept the principle that departments should be called upon to give a full accounting of their stewardship over the resources provided by Parliament, including the economy and efficiency with which these resources are mobilized towards the government's policies and priorities. I welcome the initiatives being taken by the Office of the Comptroller General in helping those of us who have to manage departments.

Some Things Can't be Audited

My personal concern relates specifically to the evaluation of effectiveness in the major policy areas of government where I have some experience. Again let me emphasize that I accept the principle of full accounting to the public on these programs, just as I do on the more operational or direct service programs. I also believe that we must do all we can to evaluate the degree to which these programs are meeting their objectives, and the social or economic effects that they may be causing. After all, it's these programs that represent the largest components of government expenditures, and we cannot ignore them.

I question, however, whether this can best be done by financial auditors, either in my own department, in the AG's Office or from some other central agency of government. The degree to which objectives are attained in policy areas is often not measureable in financial terms and they do not lend themselves to the traditional measuring techniques of a comptroller or an auditor. To the extent that the role of the auditor is pressed into this area, I think we run the danger of discrediting the AG's role in those financial areas where his work serves such an important and useful purpose. It seems to me that, if we spread our net too wide and try to measure the soft policy areas, we will really undermine the credibility and acceptibility that is essential in the measurable aspects of government activity.

Let me try to clarify what I consider to be the kinds of program that don't lend themselves to assessment by audit, by using an example within my own area of responsibility. In Energy, Mines and Resources, the largest program of this type is the Oil Import Compensation Program, put in place as a result of the oil crisis of 1973. At that time, those parts of the country that depended on foreign oil supplies were facing severe price increases and were under the threat of possible oil shortages. Meanwhile, other parts of the country were in the fortunate position of being protected by domestic supplies. Early in 1974, both federal and provincial governments agreed on the principle of a single national price for oil. Simply stated, the policy was that all Canadians should pay the same basic price for crude oil, transportation costs aside. To this policy was added a second: that Canadian oil consumers should be shielded from sudden, highly disruptive increases in oil prices. Instead, oil prices would be moved up toward world prices in a controlled and measured way. These two policies have become the cornerstone of Canada's energy policy and the Oil Import Compensation Program was one of the instruments designed to implement that policy. As this is the largest program in EM&R, involving annual disbursements of over a half a billion dollars, I am naturally eager to see that we exercise good financial control over it and that monies are being spent with all economy, efficiency and effectiveness.

What can we do to ensure this? As a starting point, we certainly must be sure we are spending the money for its intended purpose. To this end, financial audits are built into the program itself. We also have physical audits -- making certain that what's in the tanker is oil and not water. In addition, the program is routinely subjected to independent review by the internal financial audit group within my department and by the Office of the Auditor General. It's a relatively simple task to do operational audits; to assure ourselves that the program is managed efficiently. We should recognize, however, that management of the program accounts for less than one tenth of one per cent of the program expenditures.

In this particular program it is a relatively simple matter to determine if the principal policy objectives are being achieved. This does not require an elaborate evaluation process. Canadian oil prices are continuously monitored to ensure that they come within the constraints of the policy. It is also clear that Canadian oil consumers are being cushioned against the direct impact of world oil

prices. The extent of that cushion is constantly under public review at the highest levels, as witnessed by the last Provincial First Ministers' Conference.

Carrying the assessment beyond that point however, becomes more complex. For example, is it possible to inquire into some of the other effects of the program? It is possible to estimate the income redistribution consequences of the subsidized oil price as between oil-producing and oil-consuming provinces. It's also possible to examine the redistribution which has occurred between the different sectors of the economy. This, in turn, has contributed more to the competitiveness of some industries than others, and consequently more to the economy of some regions than others. In attempting to assess the impact of the program, we can further examine the adjustment process in industry under the program, seeking to compare what actually was, with what might have been without the program. We could go on studying innumerable issues and consuming more resources in that analysis. But what is the pay-off? When do we pass the point of effectiveness?

Who Can Judge?

We readily recognize that assessments of what is good and what is bad in many of these areas are highly judgmental. It most certainly is not something that one can simply express on a balance sheet. It is not the kind of assessment that I associate with auditors. In most cases, these assessments must be made by politicians, not public servants. I'm not claiming that we don't desperately need more information and analysis about what we do, but I think we need it so that the political process can debate these issues of policy in a more informed manner.

I am worried about building unrealistic expectations with respect to the value that can be derived from effectiveness evaluation. The large social, usually statutory, programs that soak up much of the federal budget, are generally very difficult to evaluate. Most of them are even more difficult than our own Oil Import Compensation Program. In most instances I don't think they lend themselves to measurement completely in financial terms, nor to the traditional approaches developed for control in industry. The economic and social effects of these programs are vastly more complex than the service or technical programs with which we have more experience.

I understand that in the United States, where there has been more experience in attempting such evaluations, there have also been many disappointments. Perhaps expectations were too high. In many instances, the extent to which the objectives are attained are very strongly influenced by external factors and it becomes very difficult to isolate the contribution of a particular program. I look forward to some of the case studies where value for money, I hope in a policy area, will be explored. I am saying that I am not persuaded but I am willing to be persuaded.

Accountability

I would like to finish up on the general question of accountability and how it interfaces with the audit. It seems to me that the lines of managerial accountability between a deputy, his minister, and central agencies are complex and unclear -- to the point where accountability is difficult to establish in policy areas. Senior public servants cease to become only managers and become policy advisors or negotiators. Under these circumstances, who really is accountable? Who will audit us? Who will judge us and how will it be done? In departments with important policy responsibilities, what should be the primary concern of the Deputy Minister? Should he be first and foremost a manager, who delegates responsibility for policy advice to subordinates? Or should he take strong leadership in policy matters and delegate the bulk of his managerial responsibilities? He will be held responsible on both counts -- his policy advice and his management -- in any event. But considering that in policy departments the greatest impact for good and for evil comes via the policy route, I'm inclined to lean towards giving the priority to policy and not to management. This means that there cannot be too many administrative, audit and evaluation functions reporting directly to a deputy head whose basic task is to manage the policy process and whose time and energy is finite.

I'm certain that we all agree that proper management of public funds and resources calls for early clarification of the diverse roles of deputy ministers and of their accountability in the progressive and unbroken chain of linkages carrying through to Parliament. As a recently appointed Deputy Minister, I'm looking forward with great interest to the Report of the Royal Commission on Financial Management and Accountability, since it, coupled with the annual Reports of the Auditor General, should move us further along the road towards value for policy as well as value for money.



Marshall A. Cohen, LL.M.

Marshall (Mickey) Cohen is Deputy Minister of Energy, Mines and Resources. Previously he had been Assistant Deputy Minister of Finance, Tax Policy and Federal-Provincial Relations Branch. After graduation from Osgoode Hall in 1960, Mr. Cohen practised law until 1970, when he joined the Federal Department of Finance. He spent seven months at Harvard University in 1977-78 associated with the Kennedy School of Government.

MANAGEMENT PERSPECTIVES: FROM THE OFFICE OF THE COMPTROLLER GENERAL OF CANADA

Harry G. Rogers

I plan to focus my remarks on two topics: departmental comptrollers and internal audit. First, the question of departmental comptrollers. There is no dispute over the concept or the desirability of this organization form. There is a large body of private sector experience and success to point to. The Office of the Auditor General is in a fortunate position, because of a fortunate mandate: to describe the situation as he finds it, and to express an opinion on it. The present Auditor General goes further and describes appropriate solutions and appropriate action. The Office of Comptroller General and the departments have the more difficult task: how to get to the desirable solution from where we are now.

A little story about the owls and the ants may illustrate. The ants on the forest floor, tired of being stepped upon and ignored, sought the advice of the wise old owls. The owl representative advised the ant representative that he would have to discuss the problem with his interdepartmental committee and would return in several weeks. Six weeks later he came back and said, "We recommend that you ants grow wings". The ant representative said, "Now listen, how can I possibly take that kind of counsel back? How do we grow wings?" To which the owl replied, "Our responsibility is for policy development and recommendations. Implementation is up to you guys." I'm not suggesting a parallel in the recommendations made by the Auditor General, but it did seem to fit.

Departmental Comptrollers - What's needed?

How we achieve a departmental comptroller organization is complex. I would like to examine the credentials and functions of a comptroller organization in the private sector, translate this into government terms and then describe some of the problems we have to overcome to make the comptroller organization form effective.

For a private sector chief financial officer, there are only five professional areas of competence: (1) accounting and administration; (2) financial planning and analysis; (3) systems and data processing -- to manage, not to do; (4) manufacturing cost and cost control; and (5) treasury operations. It is clear that

several of those latter categories depend on the nature of the firm or industry. But all comptrollers everywhere must have at least two of the five professional qualifications: accounting and administration and financial planning and analysis.

In government, the chief financial officer, generally at the ADM level, and the senior full-time financial officer, generally at the director general level, have experience in only accounting and administration. Planning and analysis is often a separate activity and is focussed on a macro level of planning activity appropriate to the department needs. It is largely the preserve of economists and statisticians. There is a missing element -- the staff and skills that relate to the planning and analysis and the tools for control of the government enterprise at the level of the responsibility centre manager and one or two levels of management above. We have to build this missing organizational element before comptrollers can be made effective as equal partners in the management of government organizations.

We have to redefine the role of the planning organization in departments to distinguish between the planning and the analysis functions that serve the departments, and the planning and analysis functions that belong to the financial function. There must be a department planning function; these activities must not *all* be placed under the financial function. At Xerox, I would never have considered putting marketing planning or the planning of service operations under finance. What we need in government is balance in roles and skills so that the comptroller can play an appropriate role, as financial advisor, on courses of action decided by deputy ministers.

We have much to do to build the infra-structure of high-quality accounting systems, meaningful and timely financial reports, and appropriate financial controls over cash, inventories and fixed assets. While these have improved markedly in the past few years, deputy ministers and operational and program managers still have a lot to say about the need for the existing financial functions -- doing only the first of the five tasks I mentioned -- to do their job better before the financial function is given a broader role. We have a problem of attitudes to deal with and these attitudes will change only when support and improvement is demonstrated; which brings us to an issue of skills.

We have doubled the number of financial officers in government in the past four years, from just over 1200 to about 2500. This has involved the moving in and out of about 8,000 people, when promotions, transfers and severances are taken into account. A common complaint is that the tenure of financial officers is woefully short and that experience and skills are terribly limited. But when you double the size of any organization in three or four years, you are bound to have problems. We have a major training job to do and we have a major acquisition job to do -- and we are doing a lot in these areas right now.

We must cross-train financial officers in analytical and problem-solving skills, through job rotation into the planning environment, and we need to do the same thing in reverse. I'd suggest that this is an important need within the Auditor General's Office as well. We need to have operations and program officers spend some portion of their careers in financial jobs, particularly the

"high fliers" in departments. There are problems in doing this because of the job classification system and we are working on this with the Public Service Commission and with the Personnel Policy Branch of the Treasury Board Secretariat. These problems will be solved, but they take time.

To summarize, we have an organizational issue in the separation of financial administration and the planning and analysis activities in departments, and a consequent absence of experience and skills in analytical processes in the financial community. There is a need to redefine the planning and analysis activities in departments and, concurrently, to build the planning and analysis capability that serves the operational and program managers' needs for information and process. The issue of attitudes of non-financial managers must be addressed before we can broaden the role of financial activities in departments. Rapid growth in the numbers of financial people has resulted in the need to upgrade skills and acquire better skills.

Much is being done to deal with these problems. There is enough evidence of good basic systems, organization strength and determination to proceed, to give me confidence that we will get there. If we proceed too quickly in the organization of departmental comptrollers, without solving the issues I have raised, we will fail. And if we fail, it will be five years or more before deputy ministers and other senior managers will be tempted to try again. This result we must avoid at all costs.

Internal Audit

Let me turn to the subject of internal audit and start by saying that we have absolutely no quarrel with the concept and conduct of comprehensive audits. This has always been the basis upon which the evolution of internal audit in departments has been planned. The start of this process began three years ago, when the Treasury Board Secretariat tried to get the internal financial audit activities on their feet. The next stages were always intended to ensure that comparable professional audit practices were followed in existing or new audit activities -- such as operational or managerial audits, audits of personnel policies and practices, and audits of administrative policies. We are now part way through the first step, the establishment of professional financial audit capabilities. My Office recently issued standards for internal financial audit across government. I would like to read what I wrote in the foreword to that manual:

> "This document deals with the internal audits of the financial management and control process. Its purpose is to set down standards which will guide departments and agencies in establishing or reorganizing audit groups, conducting audits, reporting findings, and promoting corrective action. It is an initial step in Treasury Board's plan to establish an integrated internal audit program in all departments and agencies; one which will examine all aspects of managerial control -- financial and non-financial."

There is of course a range of other, non-financial auditing activities going on in departments today and the need to tie these together is covered fully in this year's Report of the Auditor General. That Report also describes the actions that are underway between my office and the 20 largest departments to integrate audit activities. I would refer you to Mr. Andras' letter to Mr. Macdonell, printed at the front of the Auditor General's 1978 Report, which tells you what we expect to have in place in fiscal 1979-80. Initially I am not concerned with the organizational integration of all audit activities. We must first get the process in place, then forge a plan across all audit endeavours (financial audit or operational audit) and establish appropriate management review processes. Then, I believe, the organization form will follow readily.

Much has been said about the role of internal auditors in the area of economy, efficiency and effectiveness reviews. Regarding effectiveness, internal auditors will not *do* the evaluations; they will audit the evaluations from a procedural point of view. The conduct of systematic program evaluation must be performed by operational and program management in concert with technical experts, probably from the planning functions of the department. Using my Xerox example, I would not have the evaluation of a marketing program or the customer acceptance of a product, done by auditors. This may seem to be a self-evident statement on the conduct of evaluations, but I am finding sufficient confusion on roles to make these comments necessary. We have a particular short-term requirement to clarify intent and meaning of terms and roles between audit and evaluation activities.

I will finish these remarks in the same vein as I concluded my remarks on departmental comptrollers -- we must exercise due care as we evolve comprehensive audit activities in departments. Haste will buy waste and place success and continuity at risk, and we must again avoid this at all costs.



Harry G. Rogers, B.A.

Harry Rogers assumed the duties of Comptroller General of Canada in April 1978. He was previously Vice-President, Operations, of Xerox of Canada Ltd. and had served in several senior executive positions with Xerox in Canada and abroad. As Canada's first Comptroller General, Mr. Rogers is responsible to the Treasury Board for the quality and integrity of financial control systems and administrative policies and practices in use throughout the Public Service of Canada.

Centennial Conference
Office of the Auditor General of Canada

QUESTION PERIOD:

MANAGING PUBLIC FUNDS AND RESOURCES

Ottawa, Canada
December 7, 1978

Panelists address their questions to the speakers of the two "Managing Public Funds and Resources" sessions and to Mr. Macdonell, who joined the group at Mr. Francis' request. Mr. Francis' introductions of panelists and chairing directions have been omitted. Brief biographical notes on the panelists appear on page 83.



M. Bedford

Participants (from left to right):

Raymond Dubois, Glenn Ross, Bill Bradshaw, James Macdonell, Al Rosen, Rob Parker, Bill Wilson, Lloyd Francis (Chairman), Harry Rogers, Sylvain Cloutier, Marshall Cohen.

QUESTION PERIOD: MANAGING PUBLIC FUNDS AND RESOURCES

Thursday, December 7, 1978

Q. *Dr. Rosen:* This is directed generally to the Office -- I wonder, Mr. Macdonell, if you would like to reply to it. It seemed to me in the comment by Mr. Cohen, and I think to a lesser extent by Mr. Cloutier, there was some misunderstanding perhaps of the composition of the Office; that it is not restricted to financial auditors. Also, with regard to the Act itself, there is a line drawn between measuring effectiveness and looking at whether systems are in place to measure effectiveness. I was wondering if you wanted to comment on those points just so that we could get them clear from the start.

Mr. Macdonell: In regard to the basic question, 'Are we, who have been traditionally financial auditors, capable of value-for-money auditing and doing a proper job?', there is no question that we are becoming -- have already become -- multi-disciplinary. Tomorrow you will hear case histories of the SPICE studies which display a wide range of skills including engineering, economics and so forth, so there is no question that we are moving to cope with our new mandate effectively.

Now the second part of Dr. Rosen's question had to do with our position with regard to program effectiveness. There is a very important distinction to be made, which Mr. Cloutier (and I think to some degree Mr. Cohen) raised. The point is that we are not involved in the evaluation of program effectiveness. I am very pleased that the mandate we were given drew a very careful line and I admit, as Mr. Cloutier said, that we must walk it with great care because if we fall off the line on to the wrong side, we will find ourselves into what I describe privately as the political bear pit. Quite properly, if any representative of the AG gets there, he should be mauled by all Members of Parliament from any party because that is not our job. There is no question whatever that we are only evaluating the procedures.

Mr. Cloutier: I have no issue on what you say, Jim, but walking that thin line is very difficult and vigilance has to be exercised to make sure that the public servant or the manager is not used as a proxy in the case where an expenditure was made for reasons other than the first mandate of the activity. Whether it is economic development or social policy, it might be taking a swipe at the public servant who had no option.

Q. *Mr. Francis*: I wonder if what you are saying is, what are the limits to how far the Auditor General can go, or should go?

Mr. Cloutier: That is the question I posed in my speech; I don't know what the limits are.

* * *

Q. *Mr. Wilson*: How far is there agreement between deputy ministers (and many others in the public service) and Jim Macdonell on the real terms of his mandate and its limitations? Are you certain what the terms and limitations of the Audit Office are under the new Act, or perhaps one should say the interpretations of the new Act, or are you labouring under some degree of uncertainty -- not so much uncertainty as to what this will mean for you in the future as uncertainty over what the basic ground rules are now because they have been changed?

Mr. Cloutier: They have been changed and the questions that have been raised are really related to the fact that the Audit Office is in the process of defining the application of the concepts of comprehensive audit. What I tried to raise earlier were questions that I thought needed to be addressed while this process is going on.

Comprehensive audit is a new thing and it has not been debugged yet. What I am suggesting is that, as the techniques are refined, those questions should be addressed. I have no hang-ups about what the Auditor General Act says. Indeed, I have no hang-ups with the Wilson Committee report but as these concepts are being put in place I try to raise questions to which I feel, as a manager, I would like to know the answers. I'm a public servant; if Parliament and the Auditor General decide that is the way they are going to operate, I'm going to adapt or get out. But as a manager, I need to know what the rules of the game are.

Mr. Cohen: Let me endorse what Syl has been saying, but answering your question very directly; yes, I am uncertain, very much uncertain, how the new AG's Office is going to act and what the rules of the game are and how far and in what direction it's going to move. Let me try to elaborate a little bit. I guess one of the points is that a department is often doing things under a political mandate and you can't really fault the department for doing what they have been told to do. I don't think that between us we have clearly sorted out that terrain.

To come back to the remarks that I was trying to make in the speech I made earlier, how far into what I call the pure policy area is the AG trying to move and ought he to be? If I may go back to a comment I made to Jim last spring when we were getting a briefing on some of the SPICE activities, I'll put it to you as I did to Jim. I love to gamble and I feel like I've arrived in Las Vegas with my pockets

full of money, but the problem is that there are about seven casinos in town and I am being asked to play in all seven casinos at the same time and I don't know which one to play in. I've got the AG, the Comptroller General, the Lambert Commission, the Treasury Board -- two sides of the Treasury Board -- and I could go on and on. I've got all these casinos insisting that I play in them, all at the same time and to make it worse, in the AG's case I don't quite know what the rules for his particular crap table are yet! But I do want to play there.

* * *

Q. *Mr. Wilson:* Mr. Macdonell, when can public servants like these expect greater certainty about the ground rules and framework within which they are being asked to operate?

Mr. Macdonell: Mr. Chairman, let's analyse the question before we give the answer. What we have talked about in comprehensive auditing is five modules in one audit. We used FRAME to describe it and I hope there is no unpleasant connotation about FRAME. We start, for example, with a financial management control study. You've all been through that so there is no reason to really have any questions about what that means. It is a very logical thing for a financial auditor to do.

Secondly, reporting, which is divided into three parts. The first is the Estimates, which I think is a reasonable thing to look at, because that is how Parliament is provided with information on which it votes money. There are two other parts - the Public Accounts, which the Audit Office has been concerned with for years, and our annual Report. So I don't think we have seen anything new yet that would cause any particular problem. We next come to A which is attest and authority, and goes back about 100 years so there is not too much new there. We will skip the M for a moment. On E, which is EDP auditing, this certainly is a very logical component, I think you would agree, to any kind of a financial audit under today's conditions.

Now let's go back to the M (management controls); there, admittedly, we are on new ground. We have been at it now for close to two years. We have had to establish our own audit criteria -- they are all published in our annual Report and they are all very motherhood criteria. So there is nothing very esoteric about those. We put them all on record and we discussed every single recommendation, every single point, with every department before we put them in our Report. We are breaking new ground, but that is where we start from. There is nothing very new, I hope, to any department on the basis of what we have done up to now.

I think the most important thing in my annual Report is this, and I think Harry Rogers touched on it, Mr. Chairman: our objective is to audit systems, our objective is not to go out and do absolute auditing. I think that is a little too expensive for our shareholders who are the taxpayers. What we are really saying in Chapter 12 of our 1978 Report is 'Government, get with it; do your own auditing

and let's make sure you are doing a good job.' That is the real objective of what we are trying to do. Certainly, with the new approach given to us by Parliament, this is extremely important. In your conference kit you will see the opening statement that I made before the Public Accounts Committee and I have used some new words there; it's terribly significant, it's breaking brand new ground on what kind of auditing should be done for the shareholders to whom I report, who happen to be the taxpayers. Basically, in this room you are all our shareholders and I think that is the perspective with which we have to view things. There are your parameters, we are moving into new ground, we have telegraphed our punches. We are taking a look at payroll costs this year, and we will move with the same care on that Tier II (government-wide) issue as we have done up to now.

* * *

Q. *Mr. Parker*: I have a follow-up question on something that was said before. Isn't one of the basic difficulties of the process we are talking about, this line between policy matters and management matters? Mr. Cloutier used a truly elegant phrase in answering a few moments ago when he said, 'programs implemented for reasons other than the first mandate'. I presume, to blunt that statement a little bit, you might be referring to political actions? We had some reference to this question of the myth of ministerial responsibility and I think I would agree with this morning's speaker that in its present definition, it is largely a myth. But there is a great difficulty if loyal and effective public servants throw up their hands and say 'don't blame me, we were told to do it'. I wonder whether you have any thoughts, as a manager, of an effective way of accomplishing that without -- obviously -- spoiling the relationships that you must maintain with the Ministers of the Crown? It seems to me that there is a clear conflict on occasion between the policy advisor role and the program management role -- staff and line functions combined in one job.

Mr. Cloutier: When I said 'for reasons other than the prime mandate of the organization' sure, it includes straight political, as against policy but it also includes policy reasons such as social development, industrial development, regional development, that sort of thing. By going this way, you may be spending a higher amount of dollars than going that way, but the direction decided upon serves other government objectives and that is right and proper. To come bluntly to the question you asked me, as a manager if my minister tells me to do something for political reasons, if I disagree with him I will use my best arguments to dissuade him. If I don't dissuade him, then I have two choices: the first one is materiality: can I live with that decision? If I decide I can't, I have the option of quitting. It's as simple and as clear as that in my mind, and it has always been that clear in my mind.

Q. *Mr. Parker*: If I may follow up, Mr. Chairman, it seems to me that Ministers have a perfect right to make political decisions and that very often it is unfair for a body such as the Public Accounts Committee to criticize or appear to criticize, as we must, civil servants for programs where the decision to implement them, either at all or in a particular way, was totally beyond their control. I don't think that a civil servant should fairly be judged on that basis. It seems to me that some of the difficulties we are talking about -- relating to the objectives of the Auditor General and even the Comptroller General — are precisely in that area.

Mr. Cohen: I would like to make a comment. I endorse what Sylvain has said, but I think there is almost a trap in the semantics that we are using here. I really think that we ought to be careful about saying that there are two kinds of decisions in this world; one is the one that the civil servants make and the other one is 'a political decision'. That has a connotation about it that troubles me.

I don't think a decision made by a Minister is a political decision. What I consider to be a political decision is a decision, perhaps made by a Minister or Cabinet or Parliament, for, if you will, almost partisan political reasons, but a decision made by a Minister is a decision made by a politician perhaps, but it is not a political decision, it is a decision. I don't see this difference between 'political decisions', meaning Ministers' decisions, and what we are all collectively implying as being the right decisions; that is, that there is a political decision and a right decision. I don't see that distinction at all.

I was not here for this morning's discussion about ministerial responsibility and if the point being made is that the departments are vast and Ministers cannot be totally responsible for all the things that are going on, I have no trouble accepting that reality, but I do think that decisions are decisions. My boss is my Minister and he is not making a political decision; he happens to be a politician making a decision and it is his right and prerogative to make that decision. So I really caution all of us about this false distinction between political decisions and correct decisions.

* * *

Q. *Dr. Rosen*: Mr. Cloutier used the phrase -- something along the line 'give the child room to grow'. Mr. Cohen has said that there are many different dice games in town and I would like an elaboration on this 'room to grow' concept. Presumably all these investigations and reports and so on are because there are some problems and both of you give me the impression that with the Comptroller General now in place and other things occurring, everything will be rosy in the future. Can you elaborate on whether you are happy with what exists now -- whether the rewards and punishments are there for some of the deputy ministers?

Mr. Cohen: Let me comment on my part of the analogy -- the dice game, the casinos. My answer to your question directly would be no. I'm not happy with all that I see, nor do I think that the Comptroller General's appearance on the scene is the total panacea to it all. What I have been trying to say, when I drew that analogy, is that there are a finite number of resources available to us in the Department. We can't do it all at once, which is very different from saying that we are quite content with what we have. I'd like to see a great deal of improvement and I heartily subscribe to what the AG is up to. All I am asking for is, a) the resources to do the job, and b) the time to do the job which is very different from saying, speaking personally, that I am content with the management of EM&R in particular.

I think it wasn't long after Harry Rogers came on the job that he and I had lunch and I said, 'Harry, come on in will you, take a look at my Department from top to bottom, let me know what we can do to make it better!" I think Syl's reaction is self-evident from all the things that he spoke of earlier. Speaking on behalf of my colleagues, I would be prepared to bet that most of them are just as anxious as the AG to see a better product, a more efficient product, but we are just pleading for resources and time.

* * *

Q. *Mr. Wilson*: Mr. Macdonell, in this new concept of auditing, the value-for-money approach, presumably it must be value for money related to the purpose for which it was intended. Because the choice of the purpose is part of the parliamentary and governmental prerogative and is not the prerogative of either the public servant or, I would suppose, the Auditor General. Do I state it correctly?

Mr. Macdonell: Indeed, Mr. Chairman. Perhaps I could just amplify my answer in this respect. For economy and efficiency there is adequate technology and background to apply pretty tried and true techniques to those particular aspects. When you come to purpose, I think it is important that when a decision is made, there is satisfactory evidence, at each level of decision-making that adequate consideration has been given in financial terms to the options available. It is pretty easy to visualize a situation where a minister is presented with a set of alternatives and where a political decision is required; for example, in an area where there is great unemployment.

What we are saying, and we are saying it in writing, is that before the minister makes a political decision, we as auditors and ultimately you, as managers and deputy ministers, should have within your department sufficient assurance that the minister has had that set of alternatives so that if he makes that decision, he will know that there is an additional 'x' thousand dollars or millions of dollars needed to achieve a given purpose.

Q. *Mr. Wilson*: Syl Cloutier and Mickey Cohen, do either of you have difficulty with Jim Macdonell's reply there?

Mr. Cloutier: In the normal course of events, yes, but you know, if I wrote down all the oral instructions that I have, my God! In 25 years of public service and in -- I guess since '67, so that's 11 years of working closely with ministers and in that period I worked directly under 13 ministers -- only once did I ask my minister to give me his direction in writing because I didn't agree. I had argued and he still told me to do it. I said, 'Would you mind putting it in writing?' Never have I felt the need of making a record that I was acting under direction -- because the relationship between a deputy minister and the minister has to be one of confidence if it is going to work. If it is going to work, one has to be in the mind of the other. It's a relationship that you have to nurture all the time -- on both sides -- and the key word is trust -- and confidence.

Mr. Cohen. I would like to add a point again from a slightly different perspective. I think, Jim, that you were talking about the sort of a trail that leads up to the decision-making point. Again, in principle, I heartily endorse what you are saying -- that there ought to be a clear, financial and analytic trail that takes one up to that decision point with all the options explored, etc. In many, perhaps most cases, that's available. There are a lot of cases where either one of two things does not permit that to happen. One is that the data base just is not there, and I continually retreat to the policy area. Building a piece of policy is not like building a building; you cannot get a handle on the kinds of costs and expenditures that are necessarily involved, . . not just in terms of government expenditure, but economic costs to the economy as a whole. That is not always the case but it is often the case. The second point is that often time simply does not permit and decisions have to get made by the seat of their pants. Then the difficulty arises three years later when the crisis is long gone, when the auditors come back and in the calmness of the moment and the tranquility of hind-sight, you can't find the audit trail.

Mr. Wilson: Mr. Macdonell was making a broader point than you have attributed to him, because he wasn't talking about just the process that leads up to the decision. He was quite specifically referring to the effective, efficient and economical use of resources at each stage that follows in the implementation of that decision. Surely you can't disagree.

Mr. Cohen: No, I don't, not on that side of it.

Mr. Cloutier: No, no problem on that whatsoever, as long as you recognize that, by choosing one course of action the total bill may be higher than another course of action. When that happens, I don't think that, as a manager, I should be held responsible.

* * *

Q. *Mr. Wilson*: I'm trying to get to the roots of the reservations that you obviously have about the Auditor General's course. If I understand it properly, it seems to me that you are both exhibiting fears of being caught up in the decision-making process that is beyond your own control in which you recognize inadequacies but, not being able to control it, you don't want to be held responsible for it. Is that approximately right?

Mr. Cohen: I'm not so much focussed on this rather unusual set of circumstances in which the minister of the day wants to do X and I want to do Y. That's not the case that is worrying me because those are few and far between. The problem from my perspective is that both he and I may well want to do something which is not necessarily the cheapest way to do it, in measurable straight financial terms. I mean, we are all operating under a sort of a spectrum of government policies that range all the way from regional development to bilingualism to this and that and the next thing. So the kind of decision-making that goes on tries to take into account and priorize and balance all of those factors -- and it is not that the minister is in one place and I am in another place. That is why I was hesitating about this so-called political decision. We may both be in the same place -- the difficulty that you have is that after the fact, and even during the fact, it is very hard to quantify A and B. Very often it is not the most, in straight dollar terms, efficient decision. But it may well be the appropriate decision. That is where, in the pure realm of policy, the value for money problem gets worrisome. I don't want to say I am afraid of it; I am willing to tackle it; but I'm worried about how effective we can be.

* * *

Q. *Mr. Parker*: Just a follow-up to that. I think it is quite easy to understand the concerns that Mr. Cohen has just expressed and that to quantify, in that case, the rationale for a particular decision is difficult at the time. I would assume that the rationale behind the Auditor General's approach is not that you be necessarily required to quantify, in advance, all decisions that are made -- that is too much a black and white view of the management process -- but is there any doubt in your mind that you should be held to account for the way you made that decision at some time? It may be a rough kind of sieve to have it forced through -- an inappropriate sieve -- but it seems to me that is the only protection the public purse has: that that sieve exists.

If you must say, well it was a gut feeling and that is why I did it -- and that may be an appropriate defence at times -- then presumably there are ways in which you can be judged on how often you do that or how often you are right, or whatever. But the process, an adversary process, I think, at some times is essential, and I wonder if you agree?

Mr. Cohen: I have no trouble with being accountable; it is a question of which sieve I am being squeezed through. I don't want to be squeezed through a balance sheet when I am trying to balance off bilingualism, regional development and unemployment and some of the other things that we are all struggling collectively to deal with. That is the problem and I guess the fear is that the AG is trying to spread his wings in terms of his own resources and get away from that pure sort of financial audit. But I'm not sure whether, without duplicating the whole process, he can really come to grips with that kind of 'softer' evaluative process. I think Parliament and politicians and the public are the people to really struggle with that issue. It's not accountability, it's to whom and how.

Mr. Rogers: I think we should focus on some of the things that are indeed going on and I refer to Treasury Board's policies on program evaluation which were issued in September 1977. It requires departments to do systematic appraisals of their programs and that process, as a process, is in its planning stages now. A number of the larger departments are well advanced in the construction of those plans. We have to make that effective, initially at least in the 20 departments in which we are doing this survey. I think that gives us a frame of reference that would be the frame of reference within which the Auditor General audits, let us say, against four specific criteria:

1. Department or ministerial priority

2. Everything else being equal -- ease of evaluation

3. Everything else being equal -- the size of the "chewable chunk" of the program component

4. The expected cost in relation to the size of the program piece -- you've got to be cost-effective. We are not going to spend $50,000 to evaluate a $300,000 program piece; we will find some other way.

Those will be the criteria and that will be the priority and the plan, and we expect that the Auditor General will audit against that plan. If he doesn't, the response from the departments to the Public Accounts Committee, or to whoever else we're accountable, will be: it did not meet the four criteria. We can talk about priorities and we can talk about resources applied, as issues, but we will agree on those criteria. Those plans will be available to the Auditor General's office. So I think, with that step, we should take some of the mystery and some of the problems of communication which, inevitably, we have on this voyage of discovery, both within government and within the Auditor General's office.

Q. *Mr. Francis*: Surely the Auditor General is not limited, he can do that and other things, can he not?

Mr. Rogers: Absolutely, but there will be a frame of reference and it would, I hope, be a frame of reference that would have utility in the sense that if he elects to audit in another area, he knows that that may not be one that has been subject to a comprehensive evaluation, or indeed that it was done but it was done five years ago.

Mr. Francis: I can see that the Public Accounts Committee is going to have a few things to think about as this develops. I wonder at this stage if I could ask Mr. Macdonell if he has anything he wants to add?

Mr. Macdonell: Thank you. I don't think there is anything that I would particularly like to add. I think that we must bear in mind that undoubtedly the new mandate is causing some interesting reactions. As Ken Belbeck and his associates on the program tomorrow will be saying, when we started to ask the question 18 months ago, 'How do you know how well you are managing this activity?', we received a few startled looks and some expletives as to whether or not we had lost our senses. After a period of 18 months, we have had a remarkably fine reaction -- I want to put that on record, Mr. Chairman -- from the departments that have been concerned. I can name, for example, Transport, because Mr. Cloutier took an active interest in this whole program himself. We had an excellent meeting with his people. There is no question that we are moving in on this new approach. There is no question either, certainly not in my mind or in the minds of my colleagues, that this is a tremendously important new approach.

I think, to sum up, that I expressed, on behalf of our shareholders who are really the people in this room, that when we are dealing with public funds it is important to remember that there must be a very high standard of control. That is really the essence of the Financial Management and Control Study. In the "M" section, which is the value-for-money section, I think we are moving now to the stage where, from the standpoint of accountability, there has to be evidence that the same care in managing public funds has been exhibited, as a reasonable man would exhibit in managing his own funds. Now that is a fairly reasonable standard, I think, but that is all we are attempting to do.

Mr. Francis thanked the participants.

Lloyd Francis, M.P.



Lloyd Francis is Liberal Member of Parliament for Ottawa West and Vice-Chairman of the Standing Committee on Public Accounts. Mr. Francis earned a doctorate in economics from the University of Wisconsin and was Senior Research Economist, Department of National Health and Welfare, 1951-1960. A former Controller and Deputy Mayor of the City of Ottawa, he was first elected to Parliament in 1963 and was Parliamentary Secretary to the President of the Treasury Board in 1974-1975.

Rob Parker, M.P.



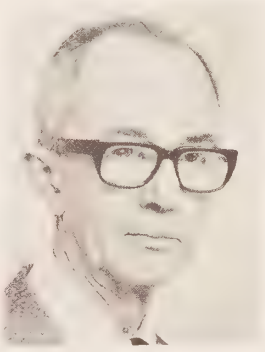
Rob Parker is Progressive Conservative Member of Parliament for Eglinton and a member of the Standing Committee on Public Accounts. Elected in his Toronto riding in October 1978, Mr. Parker has been a journalist, host and producer for TV Ontario and CBC television and frequent contributor to CBC radio and television programs. He is Vice-President and General Manager of Eskofot Canada, manufacturers of printing and office equipment.

Lawrence S. Rosen, Ph.D., F.C.A., R.I.A.



Al Rosen is professor of accounting, Faculty of Administrative Studies, York University, and consultant to the Office of the Auditor General on the ASCAM training program. He is the current President and a Founding Director of the Canadian Academic Accounting Association. A widely-published author, Professor Rosen is a member of the editorial boards of *Cost and Management* and *The Accounting Review*.

William A. Wilson



Bill Wilson is Ottawa Editor of The Montreal Star and columnist for the FP chain of newspapers. He is a former city editor and war correspondent. Mr. Wilson writes on political and economic affairs and has taken special interest in the work of the Office of the Auditor General of Canada.

The Canadian Press

Centennial Conference
Office of the Auditor General of Canada

DEVELOPING THE COMPREHENSIVE AUDITING APPROACH

Ottawa, Canada
December 8, 1978

VALUE-FOR-MONEY AUDITING

Kenneth G. Belbeck, General Chairman of Comprehensive Auditing Sessions

What is value-for-money auditing all about? The purpose of the next three sessions of this Conference is to provide some answers to that question. Throughout these presentations, which will summarize for you some of the work we have done in value-for-money auditing, the emphasis is more on how we did the work than on the audit findings and observations themselves. These findings are reported fully in the 1978 annual Report.

Is value-for-money auditing a passing fad? Not likely. The community at large, the media and the legislators are coming to expect value-for-money audits from their legislative auditors. This move began some years ago and is gaining momentum. For instance:

- One of the first value-for-money observations on record was made by the Auditor General of Canada about ninety years ago.

- The General Accounting Office of the United States Government has been conducting "Effectiveness Audits" for a number of years, and has gained world-wide recognition for its accomplishments.

- In 1975 the Independent Review Committee of the Office of the Auditor General, the Wilson Committee, recommended that the Auditor General should have responsibility for reporting on value for money.

- Three provincial auditors now have a value-for-money mandate, and similar mandates are being considered in other provinces.

- The new Auditor General Act was proclaimed on the first of August 1977 and demands value-for-money auditing.

- The 1978 Centennial Report of the Office reports three government-wide issues and thirty-five audits of departmental programs or projects under the value-for-money mandate.

- The media have given extensive coverage to the value-for-money chapters in the 1978 annual Report.

All of these developments lead to a general proposition that each organization spending public funds should be subject to value-for-money audits.

The basic challenge in all of this is sorting out just how one should most effectively conduct a value-for-money audit. The challenge faces the Auditor General of Canada and, I suggest, all legislative auditors.

Challenge and Response

The Auditor General of Canada faced this challenge early in 1976 when he recognized the mandate that was emerging in the new Auditor General Act. He decided to introduce value-for-money auditing into his Office by launching a special project. Mr. Macdonell asked me to lead this project -- the Study of Procedures in Cost Effectiveness -- which became known as SPICE. The group was staffed with a mixture of people from within the Office and professionals recruited on a short-term basis from outside the Office. We assembled quite an interesting mix of skills including accountants, engineers, economists, social scientists and general management consultants. We agreed to report the findings as part of the 1978 annual Report. I think it is fair to say that neither the Auditor General nor we who were planning SPICE anticipated the exact nature and content of the Report. However, we set about our task with vigour and, we believe, achieved the objectives we set for ourselves back in 1976.

I would like to explore briefly three simple propositions on the subject of value-for-money auditing. The first is that through this special program we have made a good start in launching the Office on a regular program of value-for-money auditing. By the time this year's Report went to press, we had completed thirty-five value-for-money audits of specific programs or parts of programs throughout the major departments of government. This year we also reported on three major issues of government-wide significance.

In each of these areas of study, we undertook the very difficult and important task of establishing and enunciating audit criteria against which we were reporting.

We have also established a growing body of methodology in the conduct of value-for-money studies. And we have provided the Office with some momentum in pursuing these studies in the future.

My second proposition is that there is still much to do in developing value-for-money auditing. We need to substantially broaden our coverage. We reported on three government-wide issues this year but there are many more that will demand attention. We have five such issues under study now and in each of these areas we have to develop the appropriate audit criteria. There may be many other areas that should be reviewed.

We also have to struggle with the question of materiality. Just what kind of findings are material in value-for-money auditing? Which of these should be reported to the deputy minister? Which of these should be included in the annual Report to Parliament? And how are these reported in the context of the entire operations of a department or agency?

Furthermore, we must develop some consistent language for expressing audit opinions. For example, what do we mean when we say a "substantial overrun", or that a system is "inadequate", or indeed "grossly inadequate"? What does "regard" mean? What does "due regard" mean? How do we set up terminology meaningful to the public yet understandable and consistent among auditors?

One of the most pressing challenges is to document the techniques and procedures that we have developed in such a form that they can be easily used by others.

And then we have a need to deal with a surprising number of policy issues that emerge in studies -- issues of a nature that one might never imagine or predict before starting to conduct the audit.

My third proposition is that clearly value-for-money auditing should be integrated with all other kinds of auditing to form a comprehensive audit.

The Office has succeeded in introducing new skills and gaining momentum by special projects, such as SPICE. Before SPICE, the Office launched a special project in computer auditing. And before that, a special project in financial management and control.

Now that the Office has a broad range of skills and experience, it is in a position to integrate them to carry out comprehensive audits.

Comprehensive Auditing

In our view a comprehensive audit is one that starts with a broadly-based preliminary assessment of the operation and identifies the key issues that are worthy of audit. Then, choosing one or more of these key issues, the audit manager brings to bear all the skills and resources necessary to accomplish the task in one integrated audit.

There are some good arguments for moving to comprehensive audits. Here are a few of them:

- A comprehensive audit is clearly the most appropriate way to make certain that the major issues are indeed being addressed. If audits are conducted on a separate basis, there is even a chance that the major issues may well fall between the cracks.

- If one takes a complete view of the entity being audited and focusses on the major issues, then one is more likely to make a balanced assessment.

- It is simply more practical from an operational point of view. Many of the audit criteria for various types of audits are similar or identical in concept. Many of the same kinds of questions have to be asked in all types of audits. It is simply unacceptable

to the auditee to respond to wave after wave of auditors. And it is simply too wasteful from an audit point of view. I suspect that one cannot argue value for money in auditing unless the auditing is conducted in an integrated or comprehensive manner.

- And, finally, I suggest that a comprehensive audit is more understandable and useful to both the auditee and the audit committee and even to the auditor himself.

The overall theme of the Conference is comprehensive auditing. Within the Office we have conducted at least one audit that is a reasonable example of what we intend by the term comprehensive audit. It is the audit of Customs operations. It is reported in this year's annual Report and it will be discussed at some length later. In conducting this audit we assembled representatives of all the special skills that the Office has in attest, financial reporting, internal auditing, financial controls, EDP auditing and the value-for-money concerns for economy, efficiency and effectiveness. This audit is not necessarily the final form in which comprehensive audits may be done but it does suggest the way of the future.

But integrating all the kinds of auditing now undertaken in the Office into comprehensive audits is much easier said than done. The Auditor General has recognized the need to develop and refine the process and has given top priority to a new project known as ASCAM -- standing for Advanced Studies in Comprehensive Audit Methodology. The objectives of this project are to prepare a comprehensive audit manual, to develop training courses in comprehensive auditing, and to prepare a book on the subject.

And now a word about the Conference program.

The next section is concerned with value-for-money methodology as it was developed during the SPICE project. It will be followed by a case history of a comprehensive audit. We felt that taking just one comprehensive audit and exploring it in some detail was probably the simplest way to describe the process that we have been following.

Following lunch, we will look at value-for-money auditing from another angle -- a government-wide study. In our chosen example, the planning of capital acquisition projects, we will discuss how we conducted individual audits within the government-wide study. This presentation will be followed by a session in which a selected panel poses questions to speakers.

Now we move to consideration of the important elements of the SPICE project, with particular emphasis on the development of value-for-money methodology.

Kenneth G. Belbeck, C.M.C.



Ken Belbeck is President of Stevenson & Kellogg, management consultants, a Director of Canadian Facts, an associated marketing research firm, and past president of the Canadian Association of Management Consultants. His career as a consultant has been concentrated mainly in general management, including organization planning and development of management control systems, in both public and private sectors. Mr. Belbeck's association with the Office as Director General of SPICE has been through the Executive Interchange Program.

DEVELOPING VALUE-FOR-MONEY METHODOLOGY: THE STUDY OF PROCEDURES IN COST EFFECTIVENESS

Ronald B. Robinson

I am going to describe how the Study of Procedures in Cost Effectiveness (SPICE) developed methodology for value-for-money auditing.

A number of us have invested two years of our lives in the SPICE project. We've done a lot of work and we think we've learned a number of lessons. It seemed a useful exercise in this Centennial Conference to try to draw together a few of these lessons and share them with you. The ideas follow roughly the chronology of the SPICE project from its inception in September 1976 through to our view today as we reflect on the 1978 annual Report which marks the end of the project.

Audit Selection and Control

The first and perhaps most important lesson we learned from SPICE centres on the importance of the beginning and the end of the audit process. In other words, the two critically important aspects: audit selection; and control of the audit process and audit results.

SPICE began in September 1976 with three pilot projects. These were selected to give us some sense of what it would be like in the cold, real world to attempt to conduct value-for-money audits. They served their purpose. They have been documented in our internal papers and laid to rest. On January 10, 1977, we assembled the team, some 60 strong, that we had recruited for the SPICE project. Over half the team was drawn from the consulting profession with representatives from the accounting profession, universities, and about one-third from the Public Service. In four days of orientation we shared general background briefings on the pilot projects and discussed the 16 information papers we developed for the orientation session.

At the end of the orientation we exhibited our first audit selection approach -- the scatter-gun approach. We selected 14 programs within government and assigned one to each of our 14 teams. The programs were picked for their diversity in order to get some sense of the audit issues involved in the various aspects of government activities.

As we launched our teams at these various audit subjects, we felt that the experience of each team would probably dictate what it would tend to look at. By and large we were right. The team with a strong industrial engineering bent identified a critical management issue as the productivity of labour in the organization under audit. A team led by a cyberneticist focussed on the information flow in the organization as a critical issue. We expected highly individualized approaches and we looked forward to capturing the best of the experience of the teams as part of our total learning process. So we began SPICE with what we might call idiosyncratic audits or individualized approaches, with each team doing its work in its own way. This seemed to us to have been standard practice for those legislative auditors already involved in value-for-money audits.

The control issues we faced were perhaps of a different order to those faced by other value-for-money auditors. Remember that we had 14 teams, all new to VFM auditing, operating largely on individual initiative. We knew that policy issues would surface and these would have to be resolved, and we knew that there would be a major problem with the consistency of positions taken in the various studies. And, finally, given the attention attracted by SPICE even in its early days, we knew there would be a fair level of scrutiny of our efforts as we conducted each study and as we published the annual Report, lining up all SPICE studies side by side.

Our response at this early stage was to require each team to produce a "scope memorandum". We allowed the team a nominal budget of 200 hours to produce a document that was presented to our Management Committee for approval. The scope memorandum required us to establish "hypotheses", stated as probable weaknesses in management control. These hypotheses were to be proved or disproved by the audit evidence gathered during the subsequent audit. Budgets were authorized and audits proceeded.

We instituted a set of review meetings with each team in an attempt to communicate SPICE policy to the teams and track their progress. Three members of our management group were assigned these responsibilities as Study Co-ordinators. As we completed the first round of studies in May 1977, two clear initiatives in the audit selection process began to emerge.

First, we developed an approach we called the "Preliminary Survey". We set out to gather sufficient background information about a department or program to identify the strategic management problems. As we identified each management problem, we attempted to assess its effect on the clarity of the issue or the likelihood of finding useful results. Then we presented an array of possible audits to our internal management group. The management group selected one or more audit subjects and authorized the investment of staff resources to pursue those lines of audit inquiry.

At about this time in our history we decided to tighten down our controls over audits. This was in part a reflection of some reactions from members of our SPICE team to the level of communication and control during the first round of studies. We developed the Preliminary Survey review, the Mid

Project Review, the Point Form Review, the Challenge Edit Review, the Office of the Auditor General release of the draft report and the Interim Report release as control points. The interim reports took some time to release as departments reacted to our draft reports.

The second approach to audit selection focussed on the identification of general issues of management control. These are issues of management information and control that recur in most departments and in many programs across government. At the end of our first round studies, we began to develop a list of general issues that we called Tier II or government-wide issues. A team was assigned to develop each issue, define its boundaries and state government-wide hypotheses that could be examined. The Tier II team formed an important control mechanism for SPICE. Some work on the government-wide issues was conducted by the team itself. Where other teams were involved in examining that issue, the Tier II team acted as both a technical resource and a quality control function, monitoring progress and outcomes of the audit.

In summary, our audit selection began as a scatter-gun approach stressing individual initiatives. It evolved to, first, a rather structured approach attempting to focus on the strategic problems facing management and, second, to a government-wide approach identifying general management problems and examining those as a general issue across government. On the other side, controls began as a scope memorandum and review meetings. They evolved to, first, a preliminary survey with specific milestones and intensive reviews and, second, a government-wide issue team specializing in an issue and monitoring both quality and technical problems of a departmental audit team working in that issue area.

Government-wide Issues of Management Control

A second aspect of SPICE is how we developed our government-wide issues. My proposition is that defining generic management issues is no easy matter. What we have been attempting to arrive at is a taxonomy or a classification of audit subjects. If we could develop a useful classification we could assign a team to concentrate on each audit subject. The team would have two responsibilities: first, develop methodology for conducting value-for-money audits of the subject area; second, explore the subject to identify and substantiate any general weaknesses in management control: these might later be reported as government-wide issues. We have concluded that no final single classification satisfies our needs; rather there is a set of classifications. Our development work should consider them in turn, developing and refining our audit approach as we understand the subjects more thoroughly by looking at them from different perspectives.

As we began to define generic issues -- our first list numbered about 10 -- we had the expected problem of significant overlap among issues, since the boundaries were not clear and the issues were not of the same general order. Project management is an example.

We identified project management as a type of management control which should be present in some circumstances. A team was set to work to define the issues and conduct audits in this area. Planning was defined as a generic management issue, capital assets as a typical type of expenditure. As it turned out, three teams were working in the same area. The project management team looked at major projects that involved the acquisition of capital assets, which was the concern of our second team. And the project management team also addressed the planning aspects of the capital acquisition. So we did the obvious and combined all three teams into one.

The outcome of this process is not quite as disorganized as my description of its development might suggest. First, there are the various types of expenditure. We have categorized them into four, the broad categories identified in the Public Accounts:

- Payroll
- Capital
- Materiel
- Transfer payments.

Then there are aspects of the management process. We have opted for the simplest possible breakdown as:

- Plan
- Operate and control
- Evaluate.

Each activity, be it a project or a program, begins with planning and then gets into operation. Each activity should be subject to some evaluation of results. When we combine these two we come up with a cut at what we might call the audit domain. This seems to me a reasonable first definition of the territory within which the value-for-money auditor might operate. It suggests to us that all aspects of government must be planned and evaluated and that these two functions are a natural part of the value-for-money audit. Much of the traditional financial audit probably falls within the "operate and control" aspects of management process. This indicates the probability of a high overlap between the traditional audit area and the value-for-money aspects.

Building on the Financial Audit Base

Implicit in this classification is another important lesson that is emerging from SPICE. Value-for-money auditing builds on the base of the financial audit mandate and extends from that into new areas of audit inquiry. Consider one example. Payroll audit is a traditional part of the audit program. The financial auditor will typically determine that a position has been authorized, that there is an incumbent and that his salary has been properly calculated. The

value-for-money auditor begins with the traditional audit approach, but he extends his audit scope to inquire into manpower planning aspects. Has that position been established according to a management procedure which satisfies our general expectations in economy and efficiency?

Beyond establishing that an individual is on the job -- that there are no horses on the payroll -- the value-for-money auditor may inquire into the classification system. Are the skills actually required in the job appropriate to the classification which the job has been given? Have proper recruiting procedures been followed to ensure that the best candidate has been selected? Are incumbents given appropriate training under appropriate management controls? When we ascertain that the pay has been properly calculated and delivered, we may extend the audit under the value-for-money mandate to inquire into the level of compensation (and perhaps even benefits) given an individual in light of the compensation of an equivalent position in the general labour market.

Development of a Government-Wide Audit Issue

Let us return for a moment to the general description of the audit domain. I have already mentioned that we used this analysis to identify the potential government-wide issues. Following the logic of this analysis, six teams were assigned. Planning and evaluation were each assigned to one team. Other teams were set up to look at the questions of payroll, capital, materiel and transfer payments with primary emphasis on the operating and controlling aspects of the management process. We expected that there would be overlap in the planning area but expected little overlap in the evaluation area. The six teams played a crucial role in the total SPICE project and I will elaborate briefly on their responsibilities, using the capital acquisition project team as an example.

The team assigned to capital projects was headed by Lorne Almack and had several responsibilities. First, they developed audit methodology. A questionnaire was developed to specify the kinds of questions the value-for-money auditor should ask as he investigates a given capital acquisition project. Out of that grew the final development of audit criteria in the capital area. Secondly, the team conducted a number of investigations. For example, Bernard Barry, a member of the Office staff, conducted an audit of the Department of Transport's acquisition of two "R" Class Icebreakers.

In addition, the team maintained an overview of capital acquisition projects conducted by other groups. A team within the Post Office was examining letter-sorting activities. The Department's monitoring of the efficiency of the operation was studied, as was the acquisition of $158 million of letter-sorting equipment. The capital acquisition team maintained an overview of this aspect of the audit.

The final output of the capital projects team was a Chapter in the 1978 annual Report -- Chapter 3. The group drafted this Chapter drawing on their general background and methodology, the work they themselves had conducted,

and the work of other teams. Using all these sources, the team developed a general position on capital acquisition projects. The Tier II Issue teams, led by senior public servants or partners in consulting firms, made a major contribution to the SPICE project and to the Office, and their contribution continues. They are now working to develop methodology for the areas not yet covered and we expect that some of their work will lead to further government-wide studies for the House of Commons.

Audit Criteria

Each of the government-wide issue studies concentrated on producing a set of criteria by which we judge the adequacy of management controls. We have applied ourselves to developing common-sense criteria which would help structure our audits and our analysis of findings and which would indicate to a manager in the public service what he would have to do to get a "clean" report. Ultimately these criteria should be useful to a member of the Public Accounts Committee, who might well use them to structure his line of questioning.

The criteria should be useful in maintaining consistency among audits. It is very important, particularly in a new area of audit, to have an even-handed treatment of results in one department as compared with results in another department. If the evidence is generally similar, we should have a consistent audit opinion. And between years in the same department, the audit judgments and opinions should be comparable and consistent to be fair to ourselves and to be fair to the department.

In light of this we identified some desirable characteristics of audit criteria which would make them useful to parliamentarians, managers and auditors. These characteristics should be few in number and stated simply.

When we began our work we looked for guideposts or references that would provide our audit criteria. We found very few. We reviewed literature on the subject, written by auditors and by general management specialists; we drew on our personal experience in other work, typically in the consulting profession; we consulted Treasury Board Directives; and we reviewed our own accumulated experience on our first round SPICE projects. All of these experiences were drawn together to begin to draft a set of criteria.

Audit Criteria: Efficiency

Consider the efficiency criteria. These will be helpful as background to the Customs work which will be discussed in the next session. We worked on these criteria for some time, coming back to redraft or redefine as our experience grew. Eventually we came up with this set:

1. Measures of performance should be relevant and accurate.

2. Performance should be adequate in comparison to a standard.

3. Reports should be tailored to management needs.

4. Performance data should be used to achieve productivity improvement.

5. Productivity measures and reports should be kept current.

We have had reaction to the second criterion -- that performance should be adequate in comparison to a standard. Appreciating the importance of the position we were taking, we established an Advisory Panel. Out of this work has come a general statement that the actual performance level should be reasonable in comparison to the standard. When standards have been established by work measurement the target for an individual should be 100% of standard. Over a period of time the minimum acceptable group performance under non-incentive conditions should be 80%, allowing for minor delays and interruptions in the work process.

When we began to review the criteria within Government we were accused of starting with management theory rooted in the '30s and from there rushing headlong toward the 19th century. What we are saying is that we expect managers in Canada's Public Service to use their initiative and ingenuity in seeking ways of improving productivity, and we also expect that they should know how their interventions have affected productivity. At the very least, is it going up or down? Where feasible, managers should know the level of productivity measured against a standard.

If a company's efficiency falls too much, the company will find itself in difficulty and perhaps bankruptcy. The market mechanism works reasonably well to ensure that the grossly inefficient do not survive. The public sector has no such basic control. Few Government programs seem assured of indefinite existence when they are created, but, once established many seem everlasting. It seems to us unlikely that a program would be terminated because of internal inefficiency. Because no external controls are available, public sector managers have a greater need than their private sector counterparts for objective measures of levels of productivity. Thus we advocate the use of work measurement standards, where appropriate.

Audit Criteria: Effectiveness

By effectiveness we mean whether programs are achieving their objectives. Our work began with reviewing literature on effectiveness; we retained advisors; and we consulted the General Accounting Office of the United States on numerous occasions. Many view the effectiveness issue as an esoteric area of management. But as we began to explore the issue, it became apparent that we were really talking about the information on program accomplishments that should be at the fingertips of every operating manager. This general concept is reflected in our criteria. They are:

1. Program objectives and effects should be specified as precisely as possible.

2. Program objectives and effects which can be measured should be identified.

3. Procedures to measure program effectiveness should reflect the state of the art and be cost-justified.

4. Results of effectiveness measurement should be reported.

5. Evaluation should be used to increase effectiveness.

First one should seek out simple indicators of program effects. For example, in a job-creation program, count new jobs. Then, where appropriate, tackle the more difficult questions; try to measure higher-order outcomes. For example, in a job-creation program, try to measure overall economic impact.

Many managers in the Public Service, and even some specialists in program effectiveness, emphasize the esoteric. They imply that nothing can be done to measure effectiveness unless we are talking about a two or three-year multi-million dollar social research program or some complex computer model. We believe such studies should be carefully cost-justified. Usually there are a series of reasonable measures that are available to program managers -- often at minimal cost. We are impressed by the kinds of measures which can be gathered if program evaluation is considered at the time a program is being designed. Reasonable information systems, including the financial system, can often produce most, if not all, of the information needed to assess the immediate outcomes of a program.

We learned a lesson in applying our value-for-money criteria and it is particularly important in this effectiveness area. As we began SPICE, we might have been accused of evangelical fervour. We seemed convinced that little had been done and that any attempts made in the Government of Canada were quite inept and inappropriate. Our basic problem was that we had a tendency to demand perfection against our criteria. When a program evaluation effort fell short in some area or where some aspect had not been evaluated we were very critical. Very early in the project one or two departments performed a most useful service by helping us to recognize satisfactory attempts. The perfect effectiveness evaluation probably doesn't exist, but it is reasonable to expect satisfactory evaluations to occur with some regularity. This points out a continuing trap for the value-for-money auditor. If he demands perfection he will never find it and he will frustrate those who have made honest efforts to discharge their managerial responsibilities.

Because we are critical of some efforts to measure effectiveness, we are seen as exposing departments and individuals to more criticism than they would have experienced had they made no attempt to evaluate effectiveness. They have taken risks and this should not be ignored. First, evaluation of

effectiveness may turn up unfavourable results; these alone may present the program manager with some difficult problems. Second, if the Auditor General is going to review the evaluation effort, the program manager may come in for another criticism if the evaluation is judged inadequate. Why then should he bother? Perhaps he should just keep his head down and avoid these risks altogether. In order to improve the quality of management in Government we must encourage those who attempt honestly to measure effectiveness. It is far better to attempt to measure and fail in the attempt than to ignore obvious opportunities to measure the outcomes of programs. This challenge for balanced reporting on the part of the Auditor General will not be easy to satisfy, but it must be done. Otherwise, the results of avoidance of attempts to measure program outcomes may be on our heads.

. . . and the Future?

First, I believe the Office needs its own methodology specialists in each main area of activity. In the efficiency area, it should have people who are experts in performance measurement. And it should have staff competent to comment on the reliability and accuracy of work measurement standards. The effectiveness question is under much better control. The Office has a group of people who are working intensively on the question of the evaluability of Government programs, identifying those aspects of a program which can be measured and measured reliably. And the Office has established a network of specialists to whom we can turn for specific measurement techniques where we are in doubt.

Second, we need to integrate our efforts. Our audit methodology has been a patchwork of value-for-money efforts and there has been little activity to date to match the language or the techniques of the traditional audit with the value-for-money audit. We are increasingly discovering that our concepts and our expectations are similar, and in those cases where they may not fit well together, the issues must be identified and sorted out. We may have to discard some definitions which have been traditional in financial audit or management science, since some of the concepts now emerging are not necessarily rooted in those disciplines. There must be a melding of disciplines and the exclusive use of the language of any one discipline may be confusing.

We must encourage the development and acceptance of audit criteria by our own staff, Government at large, and perhaps even by the Public Accounts Committee. Our criteria have stood up as a useful means of analysing the results of a dozen audit investigations in each of the three government-wide studies, but criteria will emerge in other areas as more work at a government-wide level is completed. In the future, we expect criteria such as these to be used as Government standards issued by the Treasury Board.

There are whole new areas of methodology to explore. We have much to do yet in many areas of the audit mandate. Perhaps we have handled many of the important questions but others need our attention. If we don't continue to advance in these areas, we will frustrate our own and others' expectations of integrated comprehensive audits. It is an important challenge, and the Office is responding to it on both the operational and training fronts.



Ronald B. Robinson, M.B.A., C.M.C.

Ron Robinson is a Manager in the management consulting firm of Stevenson & Kellogg where he has been responsible for many studies for clients in the public sector, including school boards, municipalities, provincial, federal and international organizations. He became Deputy Director General of SPICE in 1976, under the Executive Interchange Program. Before joining Stevenson & Kellogg in 1969 Mr. Robinson had held several managerial posts in industry.

Centennial Conference
Office of the Auditor General of Canada

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT:

CANADA CUSTOMS

Ottawa, Canada
December 8, 1978

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT: INTRODUCTION

D. Larry Meyers, Session Chairman

How will the criteria that we would like to apply to auditing efficiency and effectiveness actually work in practice? One basic question we wrestled with was, should this type of audit be done by a separate group of specialists working independently of the regular audit team, or should both efforts be integrated into one comprehensive audit?

During the first year of our mandate, we chose the first alternative because we felt a need to concentrate our efforts, to establish the mandate, introduce new disciplines and develop the basic methodology, although we recognized that our full mandate should be applied by a mixed team on an integrated basis because this would minimize duplication of effort and maximize effectiveness of audit.

For this approach, we have chosen the name comprehensive auditing and, as a memory aid, have adopted the acronym FRAME:

F - Financial controls

R - Reporting to Parliament

A - Attest and Authority

M - Management controls - economy, efficiency, effectiveness

E - EDP

As well as using the acronym FRAME we also refer to our new approach to auditing as the "4-C" approach. The presentations to follow discuss the first three Cs - comprehensive, cyclical and co-ordinated (with other auditors) - but it's worth taking a minute now to emphasize the fourth: constructive. The great challenge in reporting audit findings is to be constructive and balanced. We must be aware that our reports will cause change, and communicate our concerns clearly so that the change will be for the better. There are many conscientious public servants who recognize the need to improve existing management practices and it is essential that our Reports support them.

In the Department of National Revenue - Customs and Excise we found, for example, that Customs could benefit greatly from the use of electronic data processing. They had recognized this and were introducing it in a major project, but this was their first such undertaking and they found, as have most organizations, that there were difficulties. It would have been easy for us to have simply reported the difficulties they were experiencing, but this type of reporting could lead management to decide not to introduce new techniques in the future, on the basis that every time something goes wrong it leads to criticism from the Auditor General. We must of course report our findings, but report them with recommendations which will aid in improving management of public resources. In total, our Report should encourage management action which, if taken, would allow us to report to Parliament that due regard has been paid to economy and efficiency and that systems are adequate and can be relied upon to evaluate the effectiveness of programs.

Bringing different disciplines and approaches together has a synergistic effect that leads to a much more innovative and meaningful audit, but it poses a management problem of no small dimension. During the year, we conducted a pilot project in the Department of National Revenue - Customs and Excise to see how this might work. The team that conducted the study will discuss the benefits of that experience.

A few words about the presentations: J.-P. Boisclair, the Principal responsible for Customs, will explain planning -- important to all auditing but particularly so in the case of the comprehensive audit, because each audit will be unique and probably non-recurring. So adequate planning is absolutely vital. He will emphasize some key points, particularly the need to:

- understand the entity audited -- in this case an enforcement agency with a key revenue collection mandate, the audit of which has very little similarity to, say, the audit of a welfare program;

- concentrate limited resources -- for maximum impact, limited audit resources must be focussed on issues that are vital to the successful management of the Department; and

- identify appropriate audit skills -- the mix of skills (traditional auditors, financial managers, industrial engineers, economists, social scientists, computer experts) must be tailored to each audit.

Then Pat Lafferty -- the key man in our recent study of financial management and control systems -- will explain our approach to systems evaluation; a familiar audit tool expanded to a broader scope under our new mandate and absolutely esssential in a program such as Customs that involves high volume processing.

Next, Alan Gilmore, co-ordinator of our program evaluation work, will explain the importance of program evaluation to successful management and illustrate how it can be done and audited in an enforcement and revenue collection department.

Don Farmar, an industrial engineer, will follow. Customs inspection and assessment is labour-intensive, so that successful management is contingent on the efficient utilization of this resource. Don will explain what we would expect management to do to demonstrate due regard for efficiency, and how we conducted our audit.

Next, Don Brown will explain:

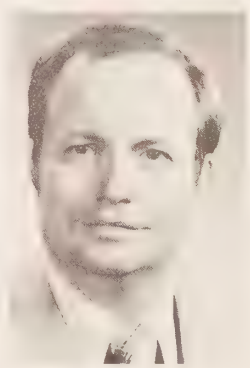
- why the use of a computer for the audit was absolutely necessary to come to grips with a system that processes 30,000 complex import transactions every day; and

- how we audited the management of electronic data processing, the efficient use of which was integral to successful management in a high volume environment.

Lastly, John Kelly, the Principal responsible for our opinion on the Public Accounts of Canada, will explain why we think that the quality of information submitted to Parliament, and our opinion on it, will be improved as a result of our comprehensive approach.

The other key component is the auditee. Success of a comprehensive audit requires the support and trust of the department or agency being audited. This we had from the beginning from the Deputy Minister of Customs and Excise and his Department -- because they believed that audit can be a constructive process -- and they participated fully and positively in the audit. They recognized that in a large organization many opportunities for improvement could well be identified and trusted in our professional judgment to present the case fairly to Parliament -- a trust which we have worked hard to honour.

D. Larry Meyers, C.A., P. Eng.



Larry Meyers is Assistant Auditor General, Control Evaluations Group, with responsibility for the Study of Procedures in Cost Effectiveness. A former Manager in the financial control systems group of Price Waterhouse Associates, he played a major role in the Office's Financial Management and Control Study, particularly in the area of the audit of Crown corporations. Mr. Meyers will co-ordinate the Office's comprehensive auditing for the 1979 annual Report.

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT: PLANNING FOR THE COMPREHENSIVE AUDIT OF CANADA CUSTOMS

Jean-Pierre Boisclair

The comprehensive auditor will need careful planning for a comprehensive audit of the large, complex organizations that legislative auditors have to deal with. My job this morning is to describe the Department of Customs and Excise, discuss its features which affected our audit design, and show how a thorough knowledge of the organization is absolutely necessary to a good strategic audit design. I will introduce the cyclical audit concept, as applied in this audit, to demonstrate a means of effectively using limited audit resources. The second part of my presentation addresses two planning issues which I'm sure you will be concerned about. These are identifying the skills required and evaluating internal audit as part of the planning process.

Let's begin with the objectives of Customs and Excise. These are to exercise control over the international movement of people and goods and to assess, collect and control duties and taxes on imported and domestically-produced goods. The Department took in $9 billion of revenue last year. To accomplish this, the Department is divided into two major parts -- Customs and Excise. Customs employs over 7,500 people. Last year it collected approximately $3 billion in revenue from about 600,000 importers. It controlled the movement of over 82 million people who crossed our borders. In contrast, Excise employs some 1,500 people, and collected over $6 billion from about 60,000 licensed tax-payers in federal sales tax, and other excise taxes on imported and domestically-produced goods.

Cyclical Auditing and Reporting

At the outset the size of the organization and the scope of its operations suggested that it was necessary to select one program for audit because:

- with limited audit resources, it would have been hard (if not impossible) to cover both programs well in one year; and
- the field work, clearance and discussion involved would have created an intolerable burden for departmental management.

We spent, for example, over 50 hours in intensive briefings with the most senior executives just to present for challenge the facts that we had gathered. Our report to the Department had 350 pages.

We felt it would be more worthwhile to apply our audit resources to one part of the Department at a time and try to do a first-rate job. We wanted to audit in a way that would best help the Department to review its operations. We were convinced that our audit should be manageable for parliamentarians in both size and content. Our solution was to establish a three-year audit cycle in which the three key components of the Department would be covered in the following sequence:

- first year: Customs
- second year: Excise
- third year: the support/expenditure functions

The cycle reflected our priorities and took into account past audit, departmental initiatives taken, and the size and complexity of operations. In summary, the cyclical approach allowed us to focus limited resources to the best advantage.

Concentrating our attention on Canada Customs only, I will give you some information on the Customs environment which influenced our audit design and which is essential to placing our subsequent findings in context.

Canada Customs has mixed objectives. It is a major collector of Canadian government revenues and a protector of Canadian society where revenue is not a major concern or is used as a protectionist device, for example:

- It protects Canadian industry. For example, a shipment of steel beams from Europe landed in Canada draws a special tax because it is being dumped at a price that undermines jobs in the Canadian steel industry.
- It provides information and services necessary to a full understanding by the public of (and their voluntary compliance with) Customs and Excise laws and regulations.
- It administers in part nearly 100 other acts of Parliament which are aimed at protecting Canadian society. For example, search of a vessel docked at Vancouver yields a cache of narcotics which would be worth hundreds of thousands of dollars on the drug market and which would contribute to a worsening social problem.
- It is responsible for the administration of Acts with major revenue implications.

We realized at the outset that it would be important to find out if the objectives of Customs had been stated so as to allow effectiveness to be measured. With a picture of Canada Customs as both a policing agency and a large financial institution, we asked what the basic features of its operations were. The key answer was that it administers and enforces a voluntary

compliance system. This system requires those subject to Canadian Customs laws to report to appropriate authorities that goods are being imported, to make a self-assessment of the applicable duties and taxes, to answer questions posed by Canada Customs truthfully, and to make the appropriate payment.

The 7,000 employees of the Customs field operations enforce Customs laws and regulations by:

- examining and releasing goods, persons and vehicles entering or leaving Canada; and
- assessing declarations made by importers and collecting import duties and taxes.

Volume and Complexity

Some numbers might help to show the magnitude of these tasks, and demonstrate why this government activity poses a unique challenge to management:

- 82 million interviews were conducted of people crossing Canada's borders last year;
- 2 million inspections of commercial goods were conducted;
- 4.6 million declarations were made for commercial goods. (These declarations were supported by at least three times that number of supporting documents);
- 1.1 million trucks crossed our border;
- 6.5 million payments were received;
- 72,000 ships were unloaded from foreign countries;
- 175,000 planes landed from outside Canada carrying both passengers and freight;
- 2 million freight cars entered Canada; and
- 1 million cargo containers were landed.

To do all this, there are 1,200 truck terminals used as sites for inspection and another 1,200 bonded warehouses, which require periodic audit and supervision. Added to this were over 3,000 tariffs and some 16,000 different commodity descriptions. In addition, Customs operations must be capable of achieving its objectives without causing undue delay in the movement of goods and people across the border.

The System Must be Responsive

In any system, particularly one that processes tremendous volumes of physical goods and related data, a natural corollary of increased control may be decreased speed or responsiveness, unless the most effective control mechanisms are chosen. Knowing this, our audit was designed to ascertain if appropriate mechanisms were in place to help in striking the right balance. Three more specific concerns affected our audit design.

First, a relatively high amount of judgment is exercised by personnel who examine goods and check the 4.6 million declarations received every year. Consider that there are 23 factors which enter into an appraisal of a customs declaration, excluding the inspection concerns. With this in mind, the audit stressed controls to ensure the quality of these operations, particularly supervisory processes and the training of staff in positions where discretion is exercised.

Second, there is the matter of geographic dispersion. There are 650 locations where goods and people enter or leave our country by land, sea, rail and air. Managing Canada Customs is obviously quite a challenge. An argument could be made that the overall strength of the system will depend on its weakest link. It stands to reason that port size will vary according to volume and traffic. In many places, volumes do not justify more than one or two Customs officials at any one location .... in other locations, hundreds of staff are employed. Appreciating this, we reasoned that some control features found in large systems would be difficult to apply. They might not even be feasible because of the cost of providing them. This caused us to look for controls appropriate to this specific environment.

Third, the relationship between examination and transportation methods was important for us to consider. A big part of Customs enforcement depends on the inspection or "physical examination" of cargo. The advent and growing use of containerized cargo makes access to the cargo for inspection more difficult and costly. Physically dealing with the inspection of containerized cargo is just plain difficult. Because of this, inspection effectiveness may be downgraded.

In summary Canada Customs has:

- mixed objectives,
- a voluntary compliance/self-assessment system,
- high volumes of goods, coupled with complex legislation and rules,
- a delicate balance between responsiveness and control,
- widespread application of judgment in many areas of operations,
- geographic dispersion, and
- diverse transportation methods.

All these combine to form a profile of Canada Customs as a unique challenge for management.

We asked ourselves what all this meant and concluded that exposure to error or fraud is inherent in a large revenue organization which must operate in this kind of environment. The complexities surrounding the legislation and regulations suggested strongly that 600,000 importers and their 600 brokers are bound to make unintentional errors in attempting to interpret and meet government requirements. In addition, there would be conscious efforts on the part of some people to escape applicable duties and taxes unlawfully or to abuse the system.

This overall profile directed our audit focus on the activities carried out by Canada Customs regarding the importation of commercial goods - since this is where the majority of revenue is derived and because this facet of the Department's activities appeared to be the linchpin of enforcement operations.

In summary, we believe that comprehensive auditing demands a more thorough knowledge of the operations of the organization than traditional auditing. With this knowledge we can audit the most important areas of managerial and financial control. We are also in a better position to analyse the potential impact of findings and formulate constructive recommendations, that is, recommendations that reflect an understanding of the realities of managing the Department.

I will discuss two fundamental parts of planning which are illustrated by the Customs audit. These are: identifying the skills required to sustain a comprehensive audit, and evaluating internal audit as part of the planning process.

Staffing the Comprehensive Audit

First, let's deal with the question of identifying required skills. With a good knowledge of the Department, our task was to design, staff, execute and report on an audit in which value-for-money auditing would be integrated into a comprehensive framework. This requires a multi-disciplined team.

The Customs example illustrates this well, and reference to some of the likely areas of audit interest posed by the profile information just presented will show how we identified the necessary skills, i.e.,

- mixed objectives, and the importance of measuring revenue and other enforcement effectiveness, predicted that program evaluation skills would be required to audit this managerial control and accountability;

- man-years allocated to the Department, together with high volumes of transactions processed at 650 locations, said that efficiency measurement would be very relevant to our audit both as a managerial and a financial control. Specialized engineering and work measurement disciplines were required to support such a line of inquiry; and

- some forms of typical internal controls are difficult to apply in this environment and cost/benefit relationships would be critical in assessing the adequacy of customs control systems. Here, two types of auditors were required. Those with the traditional financial audit discipline, (that is, auditors oriented toward the identification of control mechanisms and determining the extent of their application), and auditors with proven skills in operational research, including quantitative analysis.

Because EDP was emerging in the Department as a necessary part of the operating systems, specialist knowledge in computer audit and use of computers as an audit aid, was necessary.

The varied areas of audit interest required very different skills to support the comprehensive approach.

Assessing Internal Audit

I would like to discuss our approach in evaluating internal audit in National Revenue, Customs and Excise. First, we addressed it as part of our planning process; we wanted to know how much we could rely on internal audit in setting our audit scope. We emphasized Customs and Excise internal audit especially because it is one of the largest internal audit groups in government, with a budget of over $1.6 million and a staff complement of 65 man-years. The size, complexity and risk associated with Canada Customs operations clearly pointed to its importance.

The key aspects in the evaluation of the internal audit function were:

- the foundation of internal audit, that is, management's expectations as reflected in its mandate and its organization;

- the planning of internal audits to achieve management's expectations and thus support them;

- the techniques used by internal audit to effectively and efficiently accomplish its plans;

- internal audit reports; and

- one of the most critical components of all, the staff, who give life to the internal audit function.

Finding out what management expects from internal audit is a logical starting point in the evaluation. If management does not expect much, it is unlikely that we will be able to rely significantly on their work. If they expect less than what the operational environment demands, then they will not have obtained value for money for their audit dollars.

To draw an analogy, if one were an aeronautical engineer one might ask how high a reconnaissance aircraft has to fly if it is to achieve its stated purpose of obtaining pictures of a large area. The full scope of operations in a big, complex, high-risk organization such as Customs makes the terrain very wide indeed. To see if the internal audit reconnaissance aircraft was designed to fly high enough to get good pictures, we considered the scope of the audits predicted by its mandate. Our basic criterion was that the mandate should be broad enough to cover all key questions of control, including issues of economy, efficiency and effectiveness and thus, if these issues were well-addressed, internal audit would have given value for money spent.

The second step was to examine organization. We looked for fragmentation of the function which would tend to affect audit balance, focus and resources. Since a good mandate and good auditing must still be supported by adequate lines of reporting, particularly to the Deputy Minister, we examined reporting relationships and looked for mechanisms to guide and support the internal audit function. A well-constituted and active audit committee, and clear evidence of established procedures to deal with internal audit findings were among our key criteria.

We next examined planning -- going back to my reconnaissance aircraft analogy -- a charting of the right course to lead to the most important and productive areas. Here, our questions were designed to find out whether there was a particular pattern to the way internal audit had interpreted their mandate to result in manageable and cohesive audit plans to come to grips with their entire mandate and organization. We looked for plans that would show that the components of the organization had been clearly distinguished, with attention to their relationships. Finally, we looked for imaginative scope and vision in the audit plans.

We then went on to focus on techniques. Were these capable of sustaining audit plans and would they eventually lead to useful audit reports? The size of this organization and its internal audit group led us to expect, and I believe fairly so, that audit methods would reflect at least the state of the art in systems-based auditing, and would be capable of dealing with the high-risk environment. For example, did audit programs reflect the potential difficulty of applying a number of traditional internal controls, and did they stress alternative forms of effective controls? Were surprise audits done, as in large financial institutions? And were computers not only audited but also used as an audit tool? Our evaluation in this area stressed the need for well-applied statistical sampling methods to allow internal audit to conduct meaningful tests and to support their conclusions.

The evaluation then looked at the actual quality of the reconnaissance photos -- that is the internal audit reports themselves. Here we asked two basic questions:

- Did the reports get to management at the right time for the information to be used?

- Was the content of the reports presented in a way that demonstrated the validity of the analysis, conclusions and recommendations to encourage corrective action?

A particular concern was whether or not internal audit reports provided a proper overview to management.

Before I put the reconnaissance plane back into the hangar, I would like to refer to it again for my last point on internal audit regarding the staffing of the audit organization. Our approach recognized from the beginning that, even with the best-designed aircraft, you still need a top-notch flight crew for maximum performance. Despite the adequacy of the mandate, the planning or the documented methodology, people will always be critical to success and thus the value of internal audit. Are there enough people of the proper calibre who possess the requisite skills? This question is not always easy to answer, but one approach that we took may help. It relates to an area that I just talked about and that is planning. Only in the context of well-articulated audit plans can we answer the question of what skills and quantity of auditors are required.

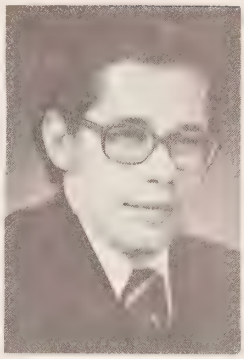
To summarize, our evaluation of internal audit, done as part of the planning process, addressed the critical components of: mandate, organization, planning, methodology, reporting and staffing.

In this particular instance, our review of internal audit led us to the opinion that we could place only limited reliance on the Department's internal audit work until significant improvements, some of which were currently underway, had been effectively implemented.

During the period under review, the Department had taken important initiatives, which we endorsed strongly, to establish a broad-scope audit mandate (including economy, efficiency and effectiveness); clear lines of reporting to the Deputy Minister; a proper statement of authority and accountability for the head of internal audit; and other procedures to enhance the potential for internal audit to play a vital part in the management process. In light of this, our ultimate recommendations were designed to help management achieve their audit expectations, which were fully compatible with our own, and to allow us to rely on their work as quickly as possible.

To sum up the audit planning issues, we have outlined the environment which both management and the auditor face and we have stressed the need for a sound knowledge of this environment so that we can focus the comprehensive audit and make useful recommendations. We have illustrated an approach to effectively allocating limited resources in a comprehensive audit -- the cyclical audit concept. We have seen the need for a multi-discipline audit team, which is a direct corollary of the issues suggested by the knowledge of the Department. Lastly, we have illustrated an approach to examining the important function of internal audit as part of the planning process.

Jean-Pierre Boisclair, C.A.



J.-P. Boisclair is a Principal in the Office of the Auditor General and a partner of MacGillivray & Co. Under the Executive Interchange program Mr. Boisclair is the Principal responsible for the development of the comprehensive audit of the Department of National Revenue - Customs and Excise. His experience includes management in the private sector and participation in the OAG's Financial Management and Control Study.

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT: EVALUATING CONTROL SYSTEMS IN CANADA CUSTOMS

Patrick D. Lafferty

Although the potential areas of audit interest in Canada Customs are numerous, an extension of the type of systems-based auditing approach now being used by auditors in the private and public sector gives us a good, logical, professional starting point for our comprehensive audits.

In this session I want to explain how we evaluated control systems in Customs. It was a demanding and imperfect process, essentially a conventional systems-based audit approach with a few important extensions and unique approaches.

First, we documented the operational and financial control systems and identified the relative degree of risk associated with each system. Second, we analysed the relative significance and cost-effectiveness of various control alternatives. Third, we developed some key control criteria or control objectives to be met in each function. Fourth, we developed uniquely tailored questionnaires and audit programs to determine if our control criteria were being achieved. Finally, we concentrated on systems weaknesses to identify cases for further examination and reporting under our comprehensive reporting mandate.

I believe that the essential lesson to be learned from the Canada Customs experience is that the normal concepts of systems-based auditing can be extended and adapted to meet our new value-for-money reporting objectives. Indeed, in large organizations, it may be the only cost-effective way for an auditor to proceed.

Understanding the Control Systems

The first step in the process was to obtain an understanding of Customs operations. In our preliminary planning, we assembled systems descriptions, organization charts, administrative manuals and tariff policies. We had interviews with some key departmental officers, and visited and observed operations in the field. The field visits in particular gave us a first-hand knowledge of the major functions of Customs and the environment in which it operates.

After this review, we began to document and examine specific systems that we thought would be strategic to our audit. The accountants on the team tended to focus their efforts on financial systems. This included preparing flowcharts of the revenue assessment and collection procedures. Other members of the team, led by an industrial engineer, documented and flowcharted some of the major operational control systems, such as the operations at border points and the physical controls over cargo movement. Another member of the team developed a program analysis to establish the potential for program effectiveness measurement.

During this process of documenting the major systems and observing operations, we became very conscious of the high risks inherent in the program. We also realized that effective controls would be hard to establish and such controls would have to be weighed in terms of their cost-effectiveness. For example, we knew that it would be very difficult (and perhaps impractical) to try to establish tight controls over the paper flow in the major ports. As we progressed with our documentation of major systems, we also began to appreciate that Canada Customs did not have an easily identifiable control system. There were a variety of differing procedures and major changes were being introduced at several locations. It was hard to know how we would handle the information already emerging and where we should be directing our future efforts to develop a useful comprehensive audit report.

In short, there were a lot of reasons for proceeding with caution.

- How would we handle the information already emerging?

- How should we be directing our future efforts to develop a useful comprehensive audit report?

To direct our efforts more productively, we decided that we would evaluate controls in terms of a three-tiered control structure. At the bottom of this structure are the numerous basic ongoing controls in the system. These were identified in our systems documentation, and included procedures for performing operations and for approving, checking and balancing transactions and records. We realized that any intensive effort to evaluate or test all these controls or make specific recommendations in this area would be an exhaustive process.

A higher level of control is what we later called disciplinary controls. These controls create the orderly and informed environment which will ensure that the basic checks and balances are likely to be introduced and maintained. We also knew that it might not be cost-effective to establish segregation of duties in the smaller border posts, or in the cargo inspection process. Clearly, we could not expect Canada Customs to have an air-tight system of control.

Examples of these second level controls include management information, procedural instructions, staffing arrangements and staff training, and the role of supervisors. These controls may be difficult to evaluate, but they are important. We wanted to know if we might be justified in placing reliance on these second level controls to reinforce or supplement the basic controls. Finally, there is a third level of control emphasizing systems design, quality control programs, performance reporting, audit and evaluation.

This three-tiered control structure provided a framework for our discussion and analysis of controls and their relative significance and cost-effectiveness. For example, a weakness in basic controls might be compensated for in part by close supervisory review or by an expanded internal audit program.

In conjunction with the concept of the three-tiered control structure, we developed an analysis of the basic functions and processes vital to the Customs operations. In effect, we broke Customs operations into seven major operational functions. For example, the first function, declaration and examination, is the front end of operations in the ports of entry, beginning with the point at which Canada Customs first becomes aware that goods are being imported.

The other functions follow chronologically through the Customs process. Similar analytical and audit processes were applied to each of the seven functions. For each one of the major functions, we then established a set of key control questions or control criteria.

An Example

To illustrate I will use the assessment function. Assessment is the determination by knowledgeable officers of the correct tariff rates for particular goods. It is particularly important because of the number of variables and the degree of consistency and skill expected from staff involved in the process. For the assessment function, we developed nine control criteria. Some of these were financial and others were operational, but they all affected each other. I will discuss three of the nine criteria.

The first is the apparently simple statement that "All declarations should enter the assessment function". This criterion concerns the links between the assessment function and the previous functions. In practice, this was not an easy link to establish. There are thousands of documents flowing among thousands of employees each day and the linkage requires consideration of a range of processes and controls, including document numbering, batch controls, locking the brief-cases of couriers and the physical security of work stations.

A second criterion was "Assessments should be complete and consistent for all declarations received". This reflected our desire to know that the application of the very complex tariff policies, by specialist officers, was reliable. It involved controlling the quality of non-repetitive work by technical experts.

A third criterion was, "Management should know what is being processed, measured against a reasonable standard." This criterion, with its efficiency implications, proved also to be a vital part of what we would normally consider to be financial control. For example, by analysing input, backlog and output information for the assessment function, management is likely to become aware of any major losses of documentation, or of any decline in the time and quality devoted to assessments during peak periods.

Analysing and appreciating this interdependence of control criteria, first within functions and then between functions, required a lot of thought by the audit team, and a lot of discussion with the Department's management.

Once we had established control criteria or key control points, we developed a special-purpose questionnaire of approximately two hundred pages. This questionnaire was designed to enable our staff to identify management's controls which we knew might differ at any particular location and then to evaluate their controls against our control criteria.

Under each control criterion, the questionnaire set out a list of the types of controls we had observed or thought might work and be cost-effective. We then completed these questionnaires at a representative selection of locations and developed audit programs to substantiate our findings.

The three-tiered control structure, the control criteria developed for the seven major functions, the questionnaire and, finally, the audit programs enabled us to capture information and develop opinions about the operations as a whole, across organizational lines.

Ultimately this structure was also reflected in the format of those parts of the final reports to management and to Parliament that dealt with inadequacies in rules and procedures. Several of the functions and specific control criteria provided the focal points for more in-depth examinations to quantify or otherwise assess the significance of weaknesses.

As I said at the outset, this was essentially a conventional systems-based audit approach with a few important extensions. The concept is to penetrate into management's control systems, whatever these may be, evaluate the strengths and weaknesses of these systems, and then use this information to lead to highly selective lines of enquiry designed to support all our reporting objectives. This includes our reporting objectives under economy, efficiency, effectiveness as well as those under attest and authority and our criticisms of the rules and procedures.



Patrick D. Lafferty, C.A.

Pat Lafferty is a partner in the Ottawa office of Coopers & Lybrand. He has served in his firm's Toronto, Montreal and London, England offices and specialized in business investigations and valuations. Mr. Lafferty participated in the Audit Office's Financial Management and Control Study and his association with the Office since then has included a term as Assistant Auditor General, under the Executive Interchange program.

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT: THE AUDIT OF EFFECTIVENESS MEASUREMENT AND REPORTING IN CANADA CUSTOMS

Alan R. Gilmore

The purpose of this presentation is to review with you the scope of the Auditor General's mandate in effectiveness auditing and the application of the mandate within Customs.

As previous speakers have suggested, the ultimate measure of value for money is whether or not the objectives for which Parliament has voted monies are in fact being attained. Within the Canadian parliamentary system the measurement and reporting of the extent to which programs are achieving objectives is the responsibility of government departments and agencies. The Auditor General's mandate is to determine whether the government's measurement and reporting procedures are satisfactory -- in other words, to assess whether the measurement procedures are objective, technically reliable and cost-justified and whether the results of such program evaluations are being reported to management, Government and Parliament satisfactorily.

There are two prerequisites for a successful audit of effectiveness measurement and reporting procedures in a department: first, an in-depth knowledge of the department's daily activities and concerns is needed and, second, the close links between economical and efficient operations and the attainment of objectives require that planning for the audit ensures the co-ordination of related audit activities.

Specifically, I want to outline the program effectiveness issue in the commercial operations unit of Customs and suggest how our experience in Customs can be applied to other enforcement agencies.

Identifying Effectiveness Measurement Issues

All our audits of program effectiveness measurement and reporting procedures begin with a review of the objectives of the department. The need for clear objectives which can realistically be attained by program activities is obvious. As the Auditor General observed in his annual Report, although there may be some merit in doing the right thing badly, there is none whatever in doing the wrong thing well. The outcome of our review of program objectives and activities is a program model which relates objectives, activities and effects. The program model for Customs outlined three basic program effectiveness issues.

First, the model indicated that Customs enforces a large number of laws formulated by other government departments. The ultimate purpose of these laws is to protect the Canadian economy and society. For example, enforcement of the Hazardous Products Act by Customs prevents the importation of dangerous goods, while the enforcement of the Anti-Dumping Act protects the economy from unfair foreign competition. The extent to which these laws in fact protect Canadians is a central program effectiveness issue. The measurement of the effectiveness of the laws is, however, not the responsibility of Customs but of the sponsoring departments. Thus, we did not fault Customs for not evaluating the effectiveness of the laws. But we did make note of it for our other audits.

The second issue is whether the inspection process ensures that the laws are complied with -- for example, that prohibited goods are not being imported. The measurement of the effectiveness of the enforcement process is a responsiblity of Customs. However, to measure effectiveness, Customs would need to obtain from the sponsoring department guidelines on what level of enforcement would be required for the objectives of the Acts to be attained. For example, do all goods have to be intercepted or will 80% suffice? Although Customs and the sponsor departments had discussed the problems, guidelines had not yet been established. Without them, the measurement of effectiveness would have to assume the necessity for 100% interception rate.

Because it seemed unlikely that a 100% enforcement was necessary, we recommended that Customs and the appropriate departments quickly determine what level of enforcement would be satisfactory. We noted that the guidelines would have to take time constraints into account. The need for inspection would have to be balanced against the cost of delaying the entry of persons and goods into Canada.

The third measurement issue is the extent to which the correct revenue is being collected by Customs. The collection of revenue and the determination of how much of the revenue can be collected at a reasonable cost is entirely within the jurisdiction of Customs. For this reason it was chosen as a case for illustrating how effectiveness might be measured. The collection of correct revenue depends upon three systems: examination, assessment and collection.

A review of these systems indicated that, given what we wanted to achieve and resource and time constraints, the assessment function was most easily subjected to an in-depth test. Accordingly, our Office and the Department jointly conducted a test of the assessment system's contribution to the collection of the correct revenue.

The assessment system depends upon self-assessment by the importer. That is, the importer declares the tax due, subject to possible review by Customs personnel. We selected a sample of the assessments made by importers and had them reviewed by expert Customs staff. We compared the revenue collected as a result of self-assessment with what the expert Customs appraiser said should have been collected. In general, we found the tax being collected was low; that is, the self-assessment system not unexpectedly resulted in a bias in favour of the importer.

The audit of the assessment process for a major port illustrates our findings. The port collects about a quarter of the nation-wide Customs duties. Using statistical techniques, we estimated the amount of revenue not being collected due to errors in assessment in the port for a six-month period. For this major port our best estimate of unidentified revenue was $14 million, although the range was from $5 to $22 million. The "revenue gap" of $14 million represents about 3% of the total revenue collected. In other words, the assessment system at this port was about 97% effective. One caveat to this finding should be noted. Because the test was limited to the assessment process in the port, the results should not be construed as indicative of the total revenue loss that may exist.

Collection of the correct revenue is not exclusively dependent on the assessment process and revenue loss may occur elsewhere. For example, because of the voluntary compliance aspect of the Customs operations, there is the possibility that as much or more chance of revenue loss exists in the examination function as in assessment.

We gained other insights from our work. Of particular importance was the finding that 20% of the importations accounted for 80% of the Department's revenue, and that the same 20% also proved to be the source of more than 90% of the potential revenue loss. These data suggest that by concentrating on the high-value-for-duty goods, the Department could collect as much or more revenue as it now collects, in a more cost-effective manner. While particular results of our effectiveness-measurement evaluation are interesting, they should not eclipse the wider implications.

First, it is feasible to measure the effectiveness of the assessment function.

Second, the effectiveness measurement issue we have just reviewed is not confined to the assessment function alone. Similar tests, using a statistical sampling technique in combination with other procedures such as the development of profiles of likely cases of evasion, could be applied to measure the effectiveness of other operations; for example, the examination of commercial goods.

Finally, the audit of effectiveness in Customs serves as a case illustration of the basic effectiveness issue in any enforcement agency. Simply stated, it centres on comparison of the total incidence of an event which one is seeking to control with the portion which is actually being controlled by an agency's enforcement activities. Once the size of the gap in control is known, the task becomes one of determining whether additional enforcement activities would be cost-effective. Clearly, a major variable in the equation determining cost-effective enforcement is the efficient allocation of resources.



Alan R. Gilmore, Ph.D.

Alan Gilmore is Co-ordinator, Program Evaluation, Office of the Auditor General of Canada. His special areas are effectiveness evaluation and development of evaluation guidelines and methodology. Dr. Gilmore's recent professional experience includes development and supervision of evaluation studies in two federal departments.

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT: THE EFFICIENCY ISSUE IN CANADA CUSTOMS

Donald G. Farmar

In dealing with efficiency, I will focus on two areas: how we conducted the audit and the nature of our findings.

The kind of criteria which we used to audit efficiency are:

- the adequacy of the standards used to measure performance,
- the process used to measure and report results, and
- the use made of the results to improve productivity.

To audit against these criteria, our audit team posed the following four questions:

- Is efficiency measurement feasible in this environment?
- If it is, what would we expect to find?
- How does the department measure efficiency?
- Is this adequate in comparison to what we would expect?

This audit, part of a comprehensive audit of Customs and Excise, was carried out not as a stand-alone component but as part of the audit of management controls in the Examination and Control of Commercial Operations of the Customs and Excise program. That particular sub-activity includes examination and control of all goods entering or leaving Canada and results in the assessment and collection of the applicable duties and taxes. We selected the importation of goods by highway truck transport as the subject of our audit.

Throughout the audit, emphasis was placed on the systems and procedures used by the Department to achieve economy, efficiency and effectiveness in controlling the international importation of goods and collecting the related revenue. The focus was on how managers control their operations in pursuing program objectives and how they evaluate the efficiency and effectiveness of their operation.

As in any audit, where the first step is to gain an understanding of the environment or system to be audited, we worked closely with the other members of the audit team to increase auditing efficiency, economy and effectiveness. Our fact-finding included visits to Headquarters, selected regions and ports to interview people, watch the process in action, and review documentation so that we could document and understand the system. Our analysis related to efficiency then concentrated on answering the following four basic questions.

Is Efficiency Measurement Feasible in this Environment?

The answer is yes. The processing of goods and related documentation including invoices, manifests, entry documents and releases (from the point of entry at the border through to examination, release and appraisal of the goods) is both labour-intensive and repetitive. It is possible to measure both the input and the output from these processes. In a highly labour-intensive operation such as Customs, the development, measurement, and use of systems to measure efficiency is essential to the effective use of resources and the determination of cost-effectiveness.

Having determined that efficiency measurement is possible in this environment, we asked ourselves another question.

What Would We Expect to Find in the Way of Efficiency Measurement?

The nature of Customs operations is such that although demand is uncontrollable, it can be forecast with reasonable accuracy. Staffing -- at the border at the time of entry of a truck into the country, at the border or inland port for examination of the goods being imported, or at the border, inland port or regional office for appraisal of the taxes and duties -- is very dependent on this demand.

We expected:

- that tasks and procedures would be well-defined and that work methods simplification studies would be used to streamline the processing of both goods and paper;
- that standard times would be determined for these procedures;
- that adequate attempts would be made to forecast and monitor demand;
- that actual performance would be measured and reported; and
- that staffing ratios, for processing goods and paper in examination and appraisal, would be determined by demand, cost, efficiency and the desired level of effectiveness.

Effectiveness must be considered when auditing efficiency. Otherwise one could be doing the wrong things very efficiently. A basic challenge for the Department is to conduct sufficient examination of goods to verify and encourage voluntary compliance and maximize revenue, while limiting the number of examinations, so that goods are processed within a reasonable time to meet the needs of the importing public. Therefore, the derivation of standard times for any operation must take into account the desired level of effectiveness determined from the trade-offs among the competing objectives of revenue collection, enforcement and processing time. Having defined what we would expect to find, we proceeded to the next question.

How Does the Department Measure Efficiency?

To answer this, we relied not on our previous fact-finding visits to Headquarters and selected regions and ports, but sent a team to a port of entry to evaluate the use and effectiveness of work standards at that port. We selected a port representative of a highway border port with large traffic volumes. This port was the one at which individual work standards had been initially developed by the Department for use in the preparation of work standards for other highway ports.

We found that in the early 1970s the Department had developed substantial data to measure the work of Customs operations. Most of these standards were developed by stop-watch time although some use was made of predetermined time standards. However, as procedures changed, although documentation of the procedures was kept current, the work standards for each standard operating procedure were not updated. This occurred because the performance measurement system required accurate reporting of production units and detailed calculation of earned output hours, and this was felt to be unnecessary and time-consuming by the port managers. Consequently, the standards established became inaccurate and without value and were not used by the port managers.

The Department then developed a performance indicator concept. The previously-developed time standards for each standard operating procedure required for the region were aggregated, by weighting factors, to form a primary indicator. Use of the primary indicators necessitated only two calculations per reporting period; one for commercial operations and one for international traffic. Efficiency was measured by comparing the value of the performance indicator for the current period to the value of the performance indicator at a base period. We then considered the final question.

Is This Adequate in Comparison to What We Would Expect?

There were a number of weaknesses in the system we observed. When the original work standards were developed through the use of time study, little or no performance rating was used. Performance rating allows the analyst to convert his raw "observed" time to "standard" or normal time. When no

performance rating occurs, the analyst accepts the observed operator performance as a standard. The inherent danger is that the existing work pace will be perpetuated by building it into the standard. A major part of a measurement program is upgrading standards and standard operating procedures to conform to the current work practice. This was a major problem with the work standard program. In many cases, the standard operating procedures were kept current, but the individual work standards were not.

The primary indicator concept depends not only on the work standards established for standard operating procedures, but also on a constant frequency of occurrence of activities, such as processing of immediate releases and amending entries. Otherwise, any change in this frequency would cause a change in the reported performance, although efficiency may not have changed.

In summary, although the Department has made an effort to record and communicate performance measurement data, it has achieved only limited success. Managers generally make little use of such data because the form and content of the reports do not facilitate detailed resource allocation decisions. Consequently, management personnel at all levels, from the ports to Headquarters, do not receive adequate information on the efficiency of the operations for which they are responsible.

The Department has recognized this and is attempting to address these issues as it reconsiders its approach to performance measurement. Thus, in the course of our audit, we were able to reinforce the Department's efforts in efficiency measurement and crystallize some of the weaknesses in their past approach. We suggested to the Department that, as part of their current efforts to develop a revised approach to performance measurement, they should place greater emphasis on clearly defining appropriate outputs, and on establishing work standards at a number of key work locations. This would contribute to the development of a set of national standards and to the improvement of management reports.



Donald G. Farmar, M.A.Sc.

Don Farmar is a partner of Peat, Marwick and Partners and holds a Master's degree in industrial engineering. He has wide consulting experience in both public and private sectors and has been involved specifically in efficiency studies in the Office's Study of Procedures in Cost Effectiveness.

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT: THE EDP COMPONENT OF THE CUSTOMS AUDIT

Donald A. Brown

Computer skills are a requirement of all legislative auditors today. With the continuing growth of computer use by governments, there will be an increasing need for these skills. The integration of this audit capability into the audit process is a concern being addressed by audit management in both the public and private sectors.

In 1976 and 1977, the Office of the Auditor General of Canada carried out the CAISE Study (Computer and Information System Evaluation Study). Through the use of computer auditors, the Office assessed the controls in the major systems of the Federal Government. Management processes in the government's data processing community were examined to a lesser extent -- the Office is now integrating the work of computer auditors into the comprehensive audit approach. The Customs work illustrates an attempt at this integration.

The work of computer-trained personnel can be used in a variety of ways in an audit. These uses can most clearly be divided into two categories: making use of the computer to aid the auditor in his work, and reviewing and analysing computer systems from a value for money and internal control point of view. From our work in Customs we will describe work done in each of these categories.

Using the Computer

The audit examined the use of computer programs in analysing data collected to measure the revenue gap; and the work carried out by the audit team on the Cargo Entry Processing and Collection System, a major computer system in Customs and Excise.

If auditors clearly define what work they require, computer technicians and the computer power they direct can be a useful audit aid. Measuring the revenue gap and the effectiveness of the assessment process used EDP skills extensively. The use of computers added greatly to the effectiveness of this work and in fact this work could not have been done without the use of a computer.

The audit team working on the effectiveness issue faced a number of problems. Because of the large amount of data and the importance of the findings, a supportable statistically-based sample was required. Because of the population size, samples of up to 600 items would result at each location, making manual analysis difficult if not totally impractical. And each entry in the sample included a variety of variables which had to be analysed, resulting in a large amount of data manipulation. To meet these challenges a portable computer terminal was used. Both commercially-available and specially-written computer programs were employed.

The steps in the audit process were:

- Once statistically-valid sample sizes were determined, random numbers were generated by a computer program;

- The samples were chosen and reviewed for validity;

- Data from one of the ports were thought to be the most interesting and were input to a time-shared computer system to form a computer file or data base;

- Extensive calculations were required for statistical analysis to determine the revenue gap. Two commercially-available APL programmed packages supported by specially-designed programs were used for this;

- The data were analysed in the field, using the portable terminal, and resulted in significant findings; and

- Reporting the results of the analysis in a format understandable to the audit team management and the Department was again aided by use of the terminal. By means of a general-purpose computer plotting package, a variety of graphs were produced from the data base.

The data analysis could not have been carried out effectively without the computer. Because of the ease of data manipulation, analysis is often extended beyond what might be done manually, frequently resulting in useful findings.

An example is the one Alan Gilmore referred to earlier -- in examining the assessment process and relating it to the data on the computer file, the team determined that 80% of the revenue was derived from 20% of entries at the port, and that 90% of the revenue gap came from this 20%. Using this analysis, the team recommended that the Department should consider concentrating its review of entries on high-value items. This would likely result in little drop in revenue recapture and could have important staffing implications.

Effective use of the computer, combined with statistical sampling, resulted in a statistically valid analysis of data, a detailed analysis of large volumes of data in a cost efficient manner, and effective reporting both in terms of quality of findings and clarity of presentation. It should be noted that this was all accomplished on data that was not itself the product of a computer system. The auditors on the job, in fact, computerized the data.

Assessing Controls

Let's now consider the second element of an audit that uses computer skills. Canada Customs has a need for computer processing in its operations. The amount of data processed requires the use of computer technology. Recognizing this, the Department began development of the Cargo Entry Processing and Collection System (CEPACS) in 1971.

The CAISE Study of the OAG examined the CEPACS system in 1976 and reported that:

> "The system was undertaken without the necessary capability and resources for such a large project. Throughout the developmental stages of the project, there were indications of serious weaknesses in the planning, budgeting and general management control practices. The system was not fully implemented and there was still a significant number of important questions pertaining to the basic feasibility of the system and its cost-effectiveness".

During the comprehensive audit of Customs, computer expertise was brought to bear again to examine the changes made to the CEPACS system as a result of the CAISE findings and the further studies that had been conducted by the Department. The examination was concerned with both value-for-money issues and financial control issues.

The value-for-money examination involved a review of the system development process. This review was designed to determine whether:

- the system was developed after satisfactory feasibility studies were carried out;
- the project organization and management was effective;
- the design included appropriate internal controls; and
- the system was effectively implemented.

Briefly, we found that the Department should defer further implementation of the CEPACS system until cost-benefit analyses have been completed and the underlying issues and questions, raised in departmental reports evaluating CEPACS, have been fully answered. The Department is proceeding to implement the system with some caution.

We also examined the financial control issue. Because of the operational status of the CEPACS system in one large port, it was thought appropriate to examine the internal controls built into the system as part of the general audit process. A team of computer auditors working with other team members examined the controls in the system for completeness, accuracy and validity of data processed. Control deficiencies were reported to the Department and remedial action recommended. Because of the importance of data processing to the operations of Customs, a computer auditing skill had to be brought to bear to ensure an effective audit of the Department.

Legislative and private sector auditors face the challenge of using computer auditors in the most effective manner. The integration of the resource into the comprehensive audit team can provide an effective use of the available computer skills. We have examined the use of a computer in a time-sharing mode as an integral part of value-for-money auditing. Computer terminals can of course be used in other areas of audit. The analysis of data using computer programs is a cost effective and efficient audit tool. In most departments of government, computer processing is vital to their operations. The auditor must bring computer skills to bear in his examination.

We concluded that review by EDP auditors of computer systems under development can isolate important economy issues. We have also concluded that the evaluation of controls in systems which are computerized is an important step in the audit process. Skilled computer auditors must be used in the process to ensure a high quality of findings and recommendations. In closing, then, we believe EDP audit skills can be effectively integrated into the comprehensive audit approach, resulting in the cost-efficient use of a scarce resource.



Onions

Donald A. Brown, C.A.

Don Brown is a partner of Coopers & Lybrand, Ottawa, and a member of the Computer Audit Standards advisory committee of the Office of the Auditor General. The Canadian Institute of Chartered Accountants' Gold Medallist for 1965, Mr. Brown is National Director of Computer Auditing for his firm.

CASE HISTORY OF A DEPARTMENTAL COMPREHENSIVE AUDIT: REPORTING TO PARLIAMENT

John J. Kelly

I'm going to talk about audit opinions on financial statements and disclosure of financial information, topics that we accountants can all relate to. How would comprehensive auditing affect our audit of the Government's financial statements? What effect might it have on reported financial information?

I was concerned with these questions because part of my job is to co-ordinate our audit of the Government's financial statements. I have a special interest in the information reported in the Public Accounts. I'd like to look at the audit of Customs, first, as part of our audit of the Government's financial statements, and secondly, as a means of illustrating some improvements that could be made in the information Parliament gets in the Public Accounts.

Under his new Act, the Auditor General must give an opinion on the fairness of information presented in the Government's financial statements. In fiscal 1978, the Government reported assets of $41 billion, liabilities amounting to $80 billion, budgetary expenditures of $43 billion and revenues of $33 billion. Auditing and reporting on those kinds of numbers each year is a big job (even with 300 or more professional staff) and that's only one part of our legislative mandate.

The Government's financial statements are prepared by the Receiver General and are included in the Public Accounts of Canada, that is, the annual financial report of the Government. However, each department is responsible for the accuracy of its own accounts and for the proper recording of its own transactions. All the Principals in our Office who have departmental responsibilities are involved in our examination of the Government's financial statements.

Necessary and Sufficient Auditing of Financial Statements

To cope with an audit of this magnitude we have to plan our annual examination carefully and we have to work closely with each audit Principal. Many of the criteria and methods used in our overall planning are similar to those described in the planning of the Canada Customs audit. Issues like materiality, selectivity and cyclical coverage are consistent with both. I'd like to draw your attention to two factors involved in setting the scope of our examination.

First, we had to define reasonable materiality guidelines, so that we could not only identify significant dollar items (such as customs revenue) but also identify the items where the risk of material error was greatest. These are items we audit each year. They account for 60 - 80% of the dollar values. Secondly, we have to work up a program to cover the less important, low-risk items, on a cyclical basis. This cyclical plan is now being blended with the Office-wide program for the comprehensive auditing of all Government departments.

As we applied these concepts of materiality, selectivity, and cyclical coverage, we found that our audit became more effective, and our use of audit resources more efficient; that is, we got more value for audit dollars spent.

If we look at the audit of Customs (customs revenue accounts for about 10% of total Government revenues) we see that the Department's expenditures are less than 1% of the Government total. In previous years we spent a lot of time auditing administrative expenditures, such as travel expenses. These items were of relatively low risk and were certainly not as important as revenue. When we came to planning the Customs audit we found that in the past we had been overauditing some areas because of our traditional patterns that emphasized checking numerous transactions for compliance with regulations. Our comprehensive audit plan addressed squarely the assessment, collection, and reporting of revenue as a first priority, and we were able to save audit time by reducing the resources previously allocated to extensive testing of minor administrative costs.

Control systems are the focal point of the comprehensive audit. In auditing a government that processes transactions of more than $100 billion a year, this has to be so. An organized study and proper assessment of controls and control systems is vital to the comprehensive audit of large, complex government departments and is essential for the design of reasonable and conclusive audit tests.

Comprehensive Auditing for Parliament

Over the past three years, the Office has concentrated on fully integrating the systems-based approach in our day-to-day audit activities and planning. We also recognize that to obtain the kind of evidence we need to support our audit conclusions, we have to use the most advanced auditing techniques. We have to fully utilize the variety of expertise available to us. Computerized audit techniques and statistical sampling methods are absolutely essential in auditing systems that process enormous quantities of data.

In referring to the Canada Customs work, I have attempted to highlight three features of the comprehensive audit process:

- first, planning criteria identify the important and high-risk areas so that audit resources can be used effectively;

- second, the audit approach concentrated on the control systems to ensure an adequate assessment of the audit risks and the design of appropriate audit tests; and

- third, the innovative use of advanced auditing techniques, particularly in dealing with audit problems that involve systems processing large quantities of data.

I believe that these and other features of the comprehensive audit process improve the quality of our financial audit and provide a better basis for our opinion on the financial statements of the Government of Canada.

So far, I have talked about the audit of financial information reported to Parliament. Now I would like to say a few words about the information itself and how it might be improved. For some years, this Office has advocated the disclosure of more (and more useful) information in both the Public Accounts and the Estimates. In our 1978 Report, for instance, there is a chapter on improving the financial information Parliament receives. That chapter describes ways of better presenting information in the Estimates. The key issue is accountability to Parliament. In corporate accounting the bottom line measures profitability. In government accounting the comparable measures of operational performance and program effectiveness must be developed.

We would like to see information in the Public Accounts that will provide Parliament with a full picture of a department's operations; information that will give Parliament some means of assessing those operations in terms of performance against plan and value for money. In this year's Report, the Auditor General declared his intention to focus on departmental statements in Volume II of the Public Accounts. Our Report states that "particular attention will be paid to non-financial data necessary to assess whether expenditures are made with due regard to value obtained".

Performance indicators are one example of significant non-financial data that have not been included in departmental Estimates or in the Public Accounts. Such indicators are important. They can provide Parliament with a basis for judging the success of a department in achieving its goals and the efficiency of a department in carrying out its activities. To sum up: comprehensive audits, in addressing value-for-money issues, identify ways of measuring economy, efficiency and effectiveness that can be incorporated in government plans and reports. Government accountability to Parliament would be enhanced if the Public Accounts and the Estimates included relevant indicators to measure performance. The public reporting of such indicators might also provide an additional incentive to public service managers, to maximize the effectiveness and efficiency of their operations.



John J. Kelly, C.A.

John Kelly is a Principal in the Office of the Auditor General, responsible for the audit of the Public Accounts - the financial statements of the Government of Canada. Mr. Kelly is a member of the task force developing the program of Advanced Studies in Comprehensive Auditing (ASCAM).

Centennial Conference
Office of the Auditor General of Canada

CASE HISTORY OF A GOVERNMENT-WIDE VALUE-FOR-MONEY STUDY:

AUDITING CAPITAL EXPENDITURES

Ottawa, Canada
December 8, 1978

A CASE HISTORY OF A GOVERNMENT-WIDE VALUE-FOR-MONEY STUDY: INTRODUCTION

Ronald B. Robinson, Session Chairman

This session is presented by the group that conducted one of the government-wide or "Tier II" studies: the audit of capital acquisition projects. Lorne Almack, the Tier II issue group leader, introduces the audit criteria and their underlying rationale and the audit approach. The succeeding speakers, Charles Lavoie, Oliver Kent and Ronald Warme -- all members of the capital acquisitions audit group -- discuss respectively the audits of three different types of capital acquisitions: general-purpose office buildings, Indian schools, and flood control projects involving cost-sharing with provincial governments. Each type of audit raises different problems, although the value-for-money auditing approach is common to all.

AUDITING CAPITAL EXPENDITURES: METHOD AND CRITERIA

Lorne D. Almack

The audit process examines the acquisition from the first departmental proposal through approval, project scheduling, control, construction and review. We audited a range of projects: a research building, a flood control project, an ice-breaker construction contract, a highrise office complex, a radar navigation system, an airport terminal, and an automated lightstation project. Each of these is technically very different, but our value-for-money auditing approach is common to all projects.

The Approval Process

Our audit starts with an examination of the program objectives. This leads, of course, to a definition of the capital asset objective which supports the program objective. For example, if the government has a program to reduce highway accidents and to improve highway safety, perhaps a motor vehicle test centre would be required to support the program objective. Next, the Auditor General examines the project submission; that is, the information, the facts, the rationale used to gain approval. Typical information submitted to support approval would include a forecast of future demands. All assets are built to accommodate the future and depend upon some type of crystal-ball gazing. A forecast of demand must also extend over a specific time.

The auditor would expect some evaluation of value for money over time, particularly if a "user-pay" facility is being constructed and revenues are anticipated. One would also expect project submissions to contain a feasibility or a cost-benefit analysis which impartially weighs all costs against the claimed benefits. Not only would the auditor expect a cost-benefit analysis to be conducted, but he would expect all costs to be included and only attributable benefits to be weighed on the benefit side of the scale. Project decisions have to be based on an estimate of project costs and, although there may be problems with estimating accuracy and with accounting for inflation, one would expect both plus and minus variances to occur. Frankly, we would expect estimates to be realistic and to include all costs. Seldom is there only one solution or one method of achieving a goal. The auditor will expect that all credible options have been explored and declared. The auditor anticipates that information supporting approval will be complete, provide evidence of a rational methodology, consider all options and supply the decision-maker with full information.

Planning and Control

After approval, projects must be planned, scheduled and organized. The auditor seeks evidence of a schedule, a cost forecast and a definition of key checkpoints in the schedule. He will expect to find a project organization which shows clear assignment of responsibility, authority and accountability. He will consider whether the project is adequately staffed and supported with accounting and technical expertise. As the project proceeds, he would expect to find a project control system which monitors the progress, the time taken, the quality of the project and the cost. Achievement will be regularly reported, shortfalls and cost problems highlighted. The reporting system should indicate where corrective action is needed. Finally, the project is complete. The auditor will expect to find that a review has been made of the project's success in achieving its goals.

In other words, the auditor examines the total system. He considers: were the program and asset objectives achieved? Were the conditions, costs and benefits stated in the project submissions met? Were those stated benefits reasonable, logical and frank? Was the project planned and organized, and was it controlled?

The Audit

The audit process requires a review of audit files, reports, legislation, estimates, accounts, ministerial statements, debates, annual reports, consulting reports, financial analyses, cost-benefit studies, minutes of meetings and project submissions. Following this, an interview program is conducted with key personnel familiar with the various phases of the project's management. The data is analysed and a short report of observations and recommendations is prepared and reviewed with the department. We encourage frank input from departmental experts.

Our methodology contains an audit guide. This is not a checklist; it is a reminder of evidence to review and questions to ask. Questions are grouped according to key elements and the stages in the acquisition process. For example, under defining objectives, a typical question is: "Were the objectives defined in evaluable specifications and quantified?" On reviewing the information supporting approval, we might ask: "Was there a critical review or an analysis and by whom? Were the estimates reasonable? Did they include all costs? What methodology was used and was it appropriate?" Typical scheduling questions include: "Was there a master project plan and schedule? In what form? What scheduling techniques were used? Was responsibility and authority assigned to one project manager and were there clear lines of communication?" In considering project control, we want to see the control system. How well was it documented? Did the reports assign responsibility? Was reporting timely? And we would ask if effectiveness was evaluated (if, indeed, it was evaluable), and were costs, size and schedule variances explained?

Audit Criteria

Now a word of caution. The auditor has authority only to examine whether the project was economical, efficient and whether effectiveness was evaluated. If the government chose to build the Taj Mahal at Pokinoe Junction, this would be of no concern to the capital projects auditor. He would be concerned that this Taj Mahal was built with due regard for economy and efficiency and that the stated objectives were evaluated by the department when the project was complete. The auditor would expect that all costs, benefits and other options were presented to the decision-maker, and that analytical methods used to justify the decision were sound and reasonable. In summary, he would expect the decision-maker to be provided with realistic cost estimates so that he was aware of the cost of providing secondary, social or artistic benefits.

Audit evidence comes from the department responsible for the project audited. It includes reports, correspondence, interview notes, proposal submissions, minutes of meetings and appropriate analysis. If these contain errors in methodology, a lack of financial logic, neglect of costs, or exaggeration of benefits, this could provide evidence of lack of due regard for economy. In the extreme case, if there was no audit evidence, this could also demonstrate lack of due regard for economy. Failure to analyse economy does not protect the department from an audit observation.

How can individual audits be brought together to support government-wide findings? The 13 case histories on capital projects were entered on a grid and examined according to the audit criteria. Common issues of government-wide interest became apparent. If, for example, for the audit criterion, "estimates should be realistic and include all costs", we find that on most projects costs were underestimated, we are able to generalize and provide a government-wide conclusion.

For the 1978 annual Report of the Auditor General, these findings have been translated into general audit criteria. Quoting from the Auditor General's Report: "Responsibility and accountability should be clearly defined and communicated". For example, if an objective was defined as financial viability, we would expect someone in the organization to be held accountable for the achievement of financial viability.

A second criterion is that: "Requests for funds should be supported by accurate and complete documentation." The proposal document should exhibit an unbiased analysis of the needs related to meeting the objectives. For example, if a cost-benefit analysis added a dollar value for the saving of lives as being attributable to construction of a test facility, we would question the validity of the cost-benefit study, since the saving of lives must be attributed to the test program and not to a specific test facility. We expect a full disclosure of possible options. For example, if it were possible to provide training at existing schools rather than building a new school, we would expect costs and benefits of this option to be disclosed. A realistic estimate is absolutely essential to sound decision-making. To obtain funding approval for $281 million worth of projects and then spend $694 million does not indicate that the requests were supported by accurate estimates.

"Final approval should be based on full information." Initial approval of funds should be limited to preparing plans, analysing options, preparing a design and calculating a reasonably accurate estimate. Final approval to start construction should be based on a current needs analysis and the estimates should be based on a real design. Again there should be a review of the options and a commitment to effect the objectives of the project whether these be cost savings or provision of a new service.

We find that approval in principle or approval of a concept in an early stage in decision-making provides a licence to proceed which quickly becomes irreversible.

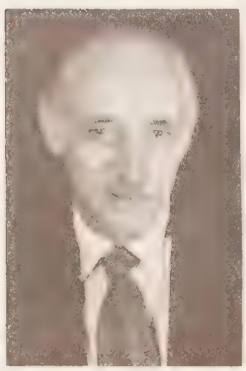
"Project implementation should be properly controlled". In particular, the size should not be allowed to grow without appropriate authorization. The quality standards applied in the design should be retained. Jobs should be constructed within the estimated cost and the schedule time allotted.

"Completed projects should be reviewed." This is essential to ensure that appropriate procedures were used, that economy was regarded, that efficiency was effected, that information supporting approval was valid, and that the objectives were met. A project review after the fact measures and imputes accountability and provides guidance for future improvement.

The Opinion

A carefully-executed capital assets audit provides the basis for an audit opinion. In the 1978 Auditor General's Report, we find: "Based on 13 SPICE audits completed to date, the capital acquisition process does not come up to a reasonable standard of due regard for economy". The process suffered from a number of shortcomings which indicate that resources of an appropriate quality were not acquired at minimum cost. Our findings are not uniform across all projects examined. Deficiencies that affected one project may not have appeared in another. Two of the 13 projects demonstrated reasonable regard for economy.

Value-for-money auditing of capital projects is practical. It can be applied consistently, and it is understandable. Three of my colleagues will present case histories describing the application of our audit method.



Lorne D. Almack, P.Eng., C.M.C.

Lorne Almack is a partner of Price Waterhouse Associates and a professional engineer with a background of management in industry. He has conducted a variety of consulting assignments in both private and public sectors. Mr. Almack was a SPICE team leader in the capital acquisition studies summarized in the Office's 1978 Report to the House of Commons.

AUDITING CAPITAL EXPENDITURES: OFFICE BUILDINGS

Charles R. Lavoie

I would like to review the audit process we are using in our examination of the General Purpose Accommodation activity in the Department of Public Works. The Department of Public Works is the federal government's major realty organization. To provide government departments and agencies with accommodation, they are currently spending about $300 million on capital assets and an even larger amount on maintaining and operating these assets. You can appreciate that this activity is of concern to the Office of the Auditor General.

Having heard our criteria you may be asking: "Just how do you go about applying these criteria? How do you carry out this type of audit?" These are certainly questions I have asked, as the audit Principal in charge of our Office's activities in the Department of Public Works. However, I know that our methodology can be applied. I think it is practical. I believe it provides for an effective audit.

We are all concerned with the practicality of performing value-for-money audits. Our experience in the Department of Public Works illustrates a process for doing these audits. Our examination of the General Purpose Accommodation activity of the Department is being conducted in two phases: first, a systems overview and identification of weaknesses; then, detailed investigations of specific projects to demonstrate and quantify the impact of weaknesses in the management process.

Planning and Control Systems Assessment

Our first step in phase one was to review and understand the roles and objectives of the Accommodation activity. We then developed a model of what a reasonable man would expect to see as a typical management process in a real estate operation. This model covered the whole process from demand forecast to disposal and review. Our third step was to examine the actual management process in effect in the Department. This was done by reviewing existing procedural manuals and by conducting interviews at all levels of the Department. Finally, we documented the management process and compared it to our model. We then reported the deficiencies to the Department, with our recommendations for improvements.

Described in these general terms, the process followed in this phase of our value-for-money audit does not appear to be complex. However, we had difficulties. For example, our criteria had not been fully developed. As a result, we had to make these up as we went along. Another example: our main audit problem was establishing satisfactory audit evidence of the non-existence of significant controls in the management process. Although essential controls were not in the Department's written manuals, this alone was not satisfactory evidence of their lack. We had to establish what procedures management was following. In the apparent absence of necessary controls, our evidence had to be confined to what management told us. Accordingly, our audit evidence for this phase of our examination consisted of interview notes. We wanted our notes to provide an accurate and complete record, so we asked each person to "sign off" our notes. These notes were given to the interviewee for his written additions, deletions or corrections.

Specific-project Audits

The second phase of our examination consisted of audits of specific projects. Our objective here was to illustrate to the Department's management the extent of dollar costs that could occur as a result of deficiencies we noted in the management process. Our first step was to prepare a detailed audit program based on our knowledge of the management process and on the criteria contained in our model. This program is now the main working document used by our audit team. We then selected specific buildings including: a project in the planning stage, a partially constructed building; a building that had just been completed, and a building that had been completed for a number of years. We completed the audit of one of these buildings and published the results in our 1978 Report. We are currently examining four others.

The foregoing is an outline of the process we followed in our value-for-money audit of the General Purpose Accommodation activity in the Department of Public Works. Although the process is practical, you may be asking yourself about the time involved in performing value-for-money audits. Our experience shows that we have progressed to the point where the level of staff used and the time involved is reasonable.

As I mentioned earlier, we examined the management process in effect over the General Purpose Accommodation activity. We certainly were finding our way at this point. Frankly, we probably spent more time than was necessary. For example, we spent over 100 man-days comprehending the Department and deciding on our approach. In addition, since this was a first-time audit, we spent an undue amount of time in editing before releasing our report to the Department. Our SPICE team spent 380 man-days to perform this examination.

We then examined the first of a number of building projects selected to illustrate the possible cost effect resulting from weaknesses in the management process. The planned and approved cost of this building project was $57 million. Two members of our SPICE team and two members of our audit team spent 250 man-days on this examination. By this time our methodology was beginning to

develop. We had learned a great deal. For example, our audits are confined to an examination of essential controls and information. In addition, we discovered that our resources could be more efficiently used if we made concurrent examinations of a number of building projects. We are now at a stage where a team consisting of a staff chartered accountant, a student who is about to write his MBA thesis, and an architect, are examining four separate building projects having planned capital costs of $200 million. This team will spend 150 man-days on this phase of our examination. I would be remiss if I did not mention other costs incidental to this examination. There is management time, including my time, and of course there is our quality control, challenge edit time. We also require some lawyer's time and a few man-days of an expert commercial lessor's time.

I believe that we can now conduct value-for-money audits of building projects in a reasonable time. Of course, the figures we have just reviewed are not impressive if we are not performing an effective audit. Our experience with our value-for-money audits of the General Purpose Accommodation activity satisfied us that our findings are significant and that they were timely.

Some Audit Problems

One of the problems with the audit of any capital project is timing. The project is complete or past the point of no return. The dollars are spent or committed. The auditor examines the project and concludes that the project could have been acquired more economically. It's too late. He is accused of closing the barn door after the horse is out. The auditee can say that he recognized the cause of that particular problem some time ago and corrected it. The auditor cannot know if this correction has really been made.

However, the process I described to you examined the managerial controls in effect today, commented on them and then examined a specific project to determine the possible dollar effect caused by the absence of necessary controls and information. For example, we observed in our report on our review of the management process that requests for funds are not supported by accurate and complete documentation. We determined this from the quality of information we saw being used as input into the Department's computer-based investment analysis model. One of our findings in the audit of the building project was that the government was not made aware that the method used to acquire the building cost approximately $12 million more than an alternative method of acquisition. Because we commented on this deficiency in the management process before we examined this specific building, the Department did not accuse us of closing the barn door too late. They accepted and recognized the problem and are rectifying it.

We also noted that it is impossible to forecast reliably the government's need for office accommodation. The resolution of this deficiency is beyond the jurisdiction of the Department of Public Works. There is no clear definition of responsibility and accountability. We noted that project control was weak. Our examination of the specific project revealed that the cost of the project was $102 million compared to planned and approved cost of $57 million. This increase is

accounted for in part by inflation, in part by the method of acquisition, and in part by design changes. In total, these observations lend support to an alternative method of funding for accommodation that the Auditor General advocated in his Centennial Report. Are we agents for change? In this instance the answer is yes. The government is currently reviewing this alternative method of funding, that is charging user departments for accommodation services -- an issue that they had considered dead as recently as 1975.

Audit Criteria

Let us now consider some important aspects of the criteria we employ in the audit of capital projects. These criteria are to the value-for-money auditor what generally accepted accounting principles are to the attest auditor. They act as an objective measure against which the observed managerial process can be compared. There is no question that they increase our credibility with the auditee and help us maintain our objectivity. In addition, although we do not perform pre-audits, we don't have to wait until a project is finished or past the point of no return before we can audit. The auditee accepts the criteria; he accepts that his system is (or is not) meeting the criteria and accordingly will accept our findings at any stage of the project. For example, we will examine a building project in the planning stage. As a result of establishing our credibility in the eyes of the department, we could very well be in a position to save the Canadian taxpayer a great deal of money.

My purpose has been to illustrate that value-for-money auditing of capital projects can be done effectively, through the resources available to the auditor, and that it can earn the auditor credibility with management of the audited organization.



Charles R. Lavoie, C.A.

Charles Lavoie is a partner in the Ottawa office of Thorne Riddell & Co. and joined the Office of the Auditor General in January 1978 under the Executive Interchange program. Mr. Lavoie has particular responsibility for all audit activities carried on in the Departments of Public Works, National Defence and Solicitor General.

AUDITING CAPITAL EXPENDITURES: INDIAN SCHOOLS

Oliver Kent

This is an example of the audit of smaller capital projects: six Indian Affairs school projects on reserves in Manitoba and Northern Ontario.

Our observations, which show serious weaknesses in the management of these six projects, are now public. But from the standpoint of a potential auditor of capital projects, or managers responsible for such audits, the question is not what we found but how we found it. I am going to look at three of our audit observations, the issues we had to resolve before those statements could be made, and the methods we used to gather the necessary evidence.

Adequate Information for Decisions

One of our criteria is that requests for approval of projects should be supported by accurate and complete documentation. The Auditor General's 1978 Report states that requests for approval of two schools made it difficult to judge whether their size was unduly large.

How did we come to make this observation? The audit guide developed early in our work on capital projects outlined the kind of information we should expect to see in requests for project approval. Treasury Board Circular 1970-5 provides a more detailed checklist. Both made it clear that a project submission should state the size of the proposed facility and should indicate why that size was appropriate.

We read the submissions for the six schools we were studying. Each included a list of the facilities to be provided. For example, the submission for the Wasagamack School listed eight classrooms, a kindergarten, principal's office, a home economics room, a gym and three houses for teachers. Were those lists accurate and complete? To find out, we compared them with the lists of requirements that were actually given to the architects.

It would be unreasonable to expect Cabinet Ministers or senior public servants to decide on details, such as whether the number of pupils at this location is sufficient to justify building a home economics room. So we asked if the Department had any standards or guidelines for school size. We found that

maximum standards had been drawn up and approved by the Treasury Board in 1969. But were those standards sufficiently clear and complete to assure the government that no school designed under them would be unduly large or lavish? Were the standards in fact observed? Working from the blueprints, we listed all the rooms provided in each school and the size of each room. We then tried to determine if that room could be included under the standards and, if so, how large it could be? We spent a few hours pondering such questions as whether the definition of a classroom was meant to include a kindergarten.

We also looked at more recently established standards. They are now set in terms of square feet per student. This provided a more convenient basis for us to make comparisons among schools. We also used it to assess the schools in relation to the standards established since they were designed.

Then, to get a first-hand look at what was built, I visited the two schools that are accessible by road. I was shown around the schools by their principals and also met representatives of the local Indian bands.

Initially, we identified three schools on whose size the government could not have made a well-informed judgment. We also had to decide if the observation was material and worth reporting. The test of materiality we used is whether a decision-maker who had accurate and complete information might have concluded that these schools were too large. Based on our evaluation of the schools in relation to the standards in force at that time, and on comparisons among the schools, we decided that the omission was material for only two of the three projects.

Let's look at another aspect of our criterion: that requests for approval should be supported by accurate and complete documentation. Cost estimates should be realistic. The estimates originally approved for these six schools totalled $7.3 million. The actual cost was $14.5 million, almost twice as much. On the face of it, that seems like proof enough that the original estimates were unrealistic. But there is more to it than that.

To begin with, when we were selecting individual projects to audit, we were aware that Indian Affairs was concerned about problems with schools built for it by the Department of Public Works, using Indian labour. We chose five recently-completed projects of this type for audit. We deliberately concentrated our limited audit resources on projects where we knew that overruns had occurred. We also examined one school that had been built within budget by a commercial contractor.

So the fact that there were overruns was hardly a surprise; nor was the existence of overruns sufficient evidence that the original estimates were unrealistic. The cost escalation might be caused entirely by lax construction management, or by inflation, or by factors which could not reasonably have been foreseen when the estimates were made. For example, four of the five local-labour schools that we looked at were built in isolated northern communities where the only year-round access is by small aircraft. In some cases freight can

be brought in only for short periods each year by tractor train or barge. Under those very difficult conditions there is some credibility to the explanation that you can run into problems which no one could have foreseen.

Accountability and Control

We also had to resolve another issue. Who was accountable for the accuracy of estimates? We were doing an audit of Indian Affairs, but Indian Affairs generally did not make the estimates. Several were made by the Department of Public Works and others by cost consultants retained by Public Works. The position we took was that Indian Affairs, as the Department requesting approval for the projects, was accountable for ensuring that the estimates it was submitting were reasonable and based on adequate preparatory work.

So how did we go about auditing the Department's performance? The criteria set out in the Auditor General's Report state that estimates should be based on the actual design of the facility. We checked the files for each project to see if the design had been completed before the estimate was made. If not, we checked to see if Indian Affairs received a revised estimate, based on the actual design, before it authorized construction to begin. And if the estimates were revised upward, we checked whether new approvals were sought immediately.

The criteria also state that estimates should be based on appropriate feasibility studies. For these schools, the main need was for engineering studies. All six projects included water filtration and sewage treatment systems to serve the schools and the teachers' houses. These systems are included because Indian Reserves generally don't have municipal water or sewage systems to which you can just hook up the schools.

Building such systems on Indian Reserves is no simple matter. The terrain at Attawapiskat, for example, is swampy while at Wasagamack there is only a thin layer of soil over the bedrock. Water and sewer systems must also be capable of withstanding the harsh climate of these northern communities.

So we looked to see if consulting engineers had been hired to report on the feasibility and cost of the water and sewage systems. If so, when were these experts retained? Were their reports received before submissions were made for project approval, or did the final decision to start construction await the receipt and consideration of the engineering studies?

We also tried to trace the history of the construction of each project. We read progress reports from Public Works, and Indian Affairs internal memoranda. We interviewed managers to determine the problems that they had actually run into during construction. We tried to establish the extent of the resulting delays and cost increases. Then, and only then, did we arrive at the conclusion that the cost estimates submitted by Indian Affairs had been unrealistic.

Program Effectiveness

The third observation could have been reported under the criterion that capital projects should be reviewed upon completion. In fact, it was published in the Report chapter on measuring and reporting effectiveness.

Five of the schools we audited were intended to be built largely by local Indian labour. The hope was that this would increase support from parents for the education program, create jobs for native people in their own communities and provide on-the-job training. It was believed at the beginning that these objectives could be achieved without adding appreciably to construction costs. The idea was a very promising one, and these projects were part of its first large-scale implementation. Yet we observed that there had been no systematic evaluation of the effectiveness of these projects in meeting their employment and training objectives.

We proved the observation very readily by interviewing Headquarters program evaluation staff as well as educators and engineers in the regions. But such an observation always runs the risk of being dismissed as academic. Our concern as auditors was to verify that it had practical significance.

By reviewing correspondence between Indian Affairs and Public Works and by interviewing managers from both Departments as well as representatives of one of the Indian bands, we established that on some projects extensive use was made of non-Indian tradesmen and subcontractors. This was a departure from the original intention that most of those hired would be local Indians. Our interviews also revealed that impressions about the economy and effectiveness of the local-labour approach influenced management decisions about the use of this approach in subsequent school projects. Our observation, that the effectiveness of these projects in achieving their job creation and training objectives was not evaluated, was therefore shown to have practical significance.

I have discussed briefly the audit work which lies behind three of the observations in the Indian schools case history. I hope these examples have illustrated that the audit evidence is solid and not hopelessly technical. Gathering it wasn't as straightforward as I may have made it sound. But I'm convinced that we have learned a great deal about how to audit smaller capital projects. At the same time, we produced audit observations significant for Parliament and for departmental management.



Oliver Kent, M.Sc.

Oliver Kent is a senior consultant with the Ottawa office of Price Waterhouse Associates. He received his Master's degree in industrial administration from Carnegie-Mellon University. Before joining Price Waterhouse Associates Mr. Kent had been an economist with a Canadian investment firm and later served the Anti-Inflation Board as an industry analyst and policy interpretation officer.

AUDITING CAPITAL EXPENDITURES: FLOOD CONTROL

Ronald M. Warme

You may be wondering whether the audit process which worked for office buildings and Indian schools would work in situations where there is both federal and provincial involvement in the same program. As the primary investigator in a value-for-money audit of three federal-provincial flood control programs, I intend to give you an overview of the nature of the federal involvement in the control of floods and flood threats so that you have some idea of the nature of the programs that we audited. I will then explain how we did this audit. I'll put particular emphasis on the audit criteria that were applied. I will then recap our major findings, our conclusions, discuss some of our evidence and, lastly, demonstrate why we believe that value-for-money auditing can encourage positive management action.

Let us look at the nature of the federal involvement in the control of floods. The occurrence of serious flooding almost every year in some part of Canada, particularly in areas of intensive flood plain and lakeshore development, poses a great many problems to all levels of government. Although the federal and provincial governments have spent millions on various protective and relief measures, losses continue and the potential for new disasters mounts with increasing development in flood-prone areas.

Governments at all levels have agreed that limiting residential and commercial development in flood-prone areas is probably the best long-term solution and steps are being taken in this direction. For example, a national flood damage reduction program is being initiated by the Department of the Environment. Where there are existing developments on flood plains, protective measures such as dykes can be an effective solution.

We are concerned here with the audit of joint federal-provincial programs for the construction of dykes along the Fraser River in British Columbia, in Southwestern Ontario, and in the Montreal area. The federal department responsible for this activity is the Department of the Environment.

Federal participation in joint flood control programs is financed through contributions. Generally the federal government contributes 45% of the cost, provincial governments contribute 45% and the local municipalities contribute 10%. Let's now look at how we conducted this audit.

Audit Criteria

Initially, we selected three criteria that we wanted to test. The first was: were requests for funds supported by accurate and complete documentation? Second, was final approval of each project, within the overall program, based on full information? And third, was project implementation properly controlled? We then designed our audit program to obtain information on these criteria. For example, on the first -- were requests for funds supported by accurate and complete documentation? -- we wanted to know what kind of information was presented to decision-makers before they approved the overall program. We asked for and obtained all the information that the Department put forward to the Treasury Board requesting the required funds. We reviewed these requests in detail, looking for unbiased analysis, for examples of alternative courses of action, and for estimated benefits in relation to expected costs. We spent a great deal of time planning the questions that we would ask relating to this and other information.

While we had an audit guide and a questionnaire prepared by a grants and contributions team looking at government-wide issues, we did not have a library of prepared questions relating to joint federal-provincial programs. We had to develop our own set of questions that would provide us with the answers relating to the criteria that we were testing. We constantly had to remind ourselves that since the federal government was only one of three participants in these programs, our audit program had to concentrate on those aspects of project planning and control where the federal government could reasonably be held accountable. For example, the responsibility for project management has been given to the provinces, yet federal representatives have a responsibility for monitoring the manner in which the provincial governments carry out their responsibilities.

I can't overemphasize the need for this pre-planning on the part of the audit team. A poor or incomplete set of questionnaires will only produce a poor or incomplete understanding of what you are auditing. We took these questionnaires on our field visits to the regional offices in British Columbia, in Ontario and in Quebec. We also conducted extensive interviews with the departmental officials at Head Office. I would like to emphasize that we were continually adding to and modifying our questionnaires as we became more familiar with the programs we were auditing. We flowcharted the entire sequence of events, beginning with the major floods that triggered all three programs, through the signing of the federal-provincial agreements and on to the actual construction. This flowcharting is, we feel, a basic early step in the systems approach to value-for-money auditing.

The final step in this process was equally important. All the answers to our questions were then carefully analysed and evaluated against our criteria. We used this procedure for each of the three criteria we were testing.

In summary, we selected the criteria, we designed an audit program, we prepared detailed questionnaires, we made field visits, we conducted extensive interviews, both in the field and at Head Office. We flowcharted the entire sequence of events and we analysed and evaluated all this information against our criteria.

Implications of Findings

As a result of this we were able to present our findings to the Department and make our recommendations. On the first audit criterion, we concluded that requests for the funds for these projects were not supported by accurate and complete documentation. Why was this criterion important to us? Our position was that if full and complete documentation was provided to decision-makers, they might have made different decisions. They might have rejected the projects or insisted that they be scaled down. For example, initial cost estimates, submitted before the signing of the agreements for all three programs, were substantially exceeded, primarily (in our opinion) because of unrealistic initial estimates and, to a lesser extent, because of inflation and changes in design standards. The Fraser River agreement, signed in 1968, provided for a federal contribution of $18 million for 44 projects. By 1976 the federal contribution had risen to $60 million for only 22 of those projects. In the Montreal program, the federal contribution increased from $2.3 to $4.5 million in one year. In Southwestern Ontario, revised cost estimates exceeded original estimates by $13 million -- one year after the agreement was signed. This resulted in a request to the Treasury Board for additional funds of $5.9 million which was refused because it could not be justified on economic grounds. The Southwestern Ontario program posed some very interesting problems to our audit team because initially the Department of Agriculture obtained approval for this program and subsequently Agriculture requested Treasury Board approval for funding. This request was approved with the proviso that responsibility for the program be transferred to the Department of the Environment.

Our audit showed that the Department of the Environment did not subject the proposed program to detailed analysis and planning before their Treasury Board submission for funds. There was no evidence of consideration of alternatives, nor any preliminary estimates of benefits in relation to expected costs. This particular issue has raised an honest difference of opinion between ourselves and the Department. To explain this difference I should say that Environment's position is that since Cabinet and the Treasury Board had both approved this program before their involvement, they should not be held responsible for justifying it. Our position is that due regard for economy requires that the final decision-maker should be provided with an objective analysis of all the relevant facts before giving final authority to proceed with the program.

The conclusion we reached on the second criterion was that final approval of each project within the overall program was not based on full information. Our evidence to support this conclusion was more difficult to establish. In the Southwestern Ontario program, there were five individual dyking projects. In three of the five projects no cost-benefit studies were conducted on any of the individual systems. That was easy evidence to find and easy to report upon. However, in two larger projects along the shoreline of Lake St. Clair and the Thames River, consulting engineers did cost-benefit studies. It was decided by the audit team that we did not have the expertise required to evaluate these cost-benefit studies. We hired our own consulting engineer to evaluate these studies and his opinion was that there were serious errors in methodology in the studies.

Our approach was to take this problem to the Department and see if it could be resolved. The result was that the Department admitted it had not reviewed these studies before the projects were implemented and they agreed with our position that incorrect methodology had been used in these studies. The result of this work, indicating the re-calculated program benefits, appears in this year's annual Report.

We believe that this last example indicates that value-for-money auditing is not always clear and straightforward. Audit teams must be reasonable, and use a great deal of ingenuity. They must recognize the complexities of many of the value-for-money audit issues. On occasion, this may require the use of outside consultants.

The final conclusion that we reached was that project implementation in two of the programs was not properly controlled. We did point out in our report that in the Fraser River program, individual projects were carefully planned, monitored and implemented but in Southwestern Ontario and in Montreal we found examples where this control was not exercised. As I mentioned earlier, under each of the three agreements project management was a provincial responsibility subject to the general direction of a federal-provincial-municipal steering committee. The federal representatives on both the Montreal and Southwestern Ontario committees did not ensure that implementation of these programs was properly controlled. To come to this conclusion, we reviewed the terms and conditions of the two agreements and tested project management compliance with them. For example, a proposed dyke at Pointe Calumet in the Montreal region was redesigned at the request of the municipality but no recalculation of costs and benefits was requested although this was a condition of the agreement. In Southwestern Ontario, individual dyking projects were implemented without the approval of the federal Minister as required under the agreement.

I stated at the outset that value-for-money auditing should encourage positive management action. The best example that I could give to support this statement is the Department. Partly as a result of our findings and our recommendations, it has agreed to the following:

- It will screen all proposed future flood control agreements in which its participation is requested. Documentation of the process for the development of federal-provincial flood control agreements has now been completed. This process will be followed in all cases in the future.

- A statement of minimum acceptable terms and conditions for all future flood control agreements is being prepared. It will include the details of project management procedures to be followed.

- Future Department of the Environment appointments to the federal-provincial joint committees on flood control will require that they comply with the terms and conditions of agreements and that they report to their Minister when their interpretation of such terms differs from that of their provincial counterparts.

- In future, cost-benefit analysis will be applied to all flood control projects, and standard procedures are being developed by the Department for such analysis. These studies, if performed by outside agencies or consultants, will also be subjected to internal analysis.

- The Department will institute procedures to measure the effectiveness of flood control programs, at least for those effects they say are quantifiable and measurable.

- Future federal-provincial flood damage reduction agreements will require that all possible alternative solutions be reviewed and evaluated before adoption of any particular flood damage reduction measurement.

We think the Department's response to our findings and recommendations makes our case. It means that value-for-money auditing can encourage positive management action. We know that capital projects are auditable; we think they are auditworthy.

Ronald M. Warme, M.B.A.

Ron Warme is a Principal in the Control Evaluations Group of the Office of the Auditor General, with special responsibilities for SPICE audits. Before joining the Office in 1978 Mr. Warme was president of his own consulting firm and had held senior executive positions in industry.



Centennial Conference
Office of the Auditor General of Canada

QUESTION PERIOD:

VALUE-FOR-MONEY AUDITING

Ottawa, Canada
December 8, 1978

Panelists address their questions to representatives from the morning and afternoon sessions on value-for-money auditing. Mr. Rayner's introductions of panelists and chairing directions have been omitted. Brief biographical notes on the panelists appear on pages 175 and 176.



M. Bedford

Participants (from left to right):

Carol MacIvor, Bill Rogers, Michael Rayner (Chairman), Joseph San Miguel, Norm Scott, Ken Belbeck, Larry Meyers, Ron Robinson, Lorne Almack, J.-P. Boisclair.

QUESTION PERIOD: VALUE-FOR-MONEY AUDITING

Friday, December 8, 1978

Q. *Mrs. MacIvor:* In talking about capital expenditure programs or things like that, might not there be some kinds of acquisitions which might not bring back any revenue or for which you might have a very difficult time measuring benefits -- cenotaphs and such things come to mind. How can an auditor decide the value for money in something like that?

Mr. Almack: The auditor would still be required to examine and comment on whether the estimate was reasonable. Even for an object built for aesthetic purposes, we would want to know that the estimate was reasonable. We can't define or quantify the benefit of social programs or works of art but we certainly can quantify their cost. We would want to know that the whole thing was reasonably presented -- whether other options were considered, if there were other options. In summary, we would like to see that the cost of an aesthetic benefit is presented fairly. We're not trying to and we will refuse to make a political decision and to evaluate the effectiveness of that kind of program. That is not the auditor's jurisdiction.

* * *

Q. *Mr. Rogers:* I have given some thought to the question of the mandate of the Auditor General of Canada. He has to report on any cases in which he has observed that money is being expended without due regard to economy and efficiency. My mandate is somewhat different. The danger was foreseen that you could get into a situation where the department had relied on its management consultants but the auditor, also involved with management consultants, would come up with a different answer. Who would resolve the two answers, both of which were arrived at, using very acceptable methods, by two sets of consultants? So our emphasis is not on the decision itself, but on the mechanism from which the decision is derived. That appears to be the thrust of the Auditor General of Canada. Ken, I wonder if you would care to comment on that?

Mr. Belbeck: I think that the emphasis on all of the value-for-money work has been on auditing the systems that are put in place to guide economy, efficiency and effectiveness. I think perhaps more reliance can in some cases be put upon systems than in others. In the purely financial area we might find that a good system might indeed satisfy our objectives. That might not be so, however, in "softer" cases where some judgment is applied. Although we are intent on determining whether or not appropriate management systems are in place, the Office feels that it is necessary, on occasion, to sample the results of those systems to see if the good intent that is provided in the system is reflected in the actual result.

* * *

Q. *Dr. San Miguel:* It seems that the ultimate test of the comprehensive auditing and value-for-money approach is measured in terms of the benefits to the stakeholders, yet I haven't observed a lot of evidence on what exactly these benefits are and, in fact, whether they do exist. Could you comment on that?

Mr. Belbeck: I guess this has plagued us from the beginning of the project: could we give Mr. Macdonell a statement of just what number of dollars might return to the stakeholders if all of our recommendations were followed? We have found that an extremely difficult task and we really haven't attempted it in any kind of a cohesive fashion. Certainly, I think we are conscious of a number of cases where it would appear that, as a result of the questions we have asked, there are changes in behaviour and where we can identify significant changes in future cost as a result of these, but we have made no attempt to quantify them or bring them together.

Q. *Dr. San Miguel:* As a follow-up question, who do we define as the stakeholders or, if you want, the shareholders who are the potential beneficiaries of comprehensive auditing?

Mr. Almack: I would say obviously the taxpayers, ultimately.

* * *

Q. *Mr. Scott:* I think you can realize that we took an extremely keen interest in your last example because Ontario also has a 45% share in this particular project. So I'm wondering, from our own standpoint on economy and efficiency, if in the future we could do some joint auditing in this area to make the best utilization of our resources and manpower and therefore eliminate any duplication in joint cost-sharing projects.

Mr. Meyers: I think the answer would be definitely yes. I'm sorry we didn't, even in this particular project. I am not certain what you'd mean by joint auditing. I'm not certain that I'd see it as your people coming in and doing an audit of the federal Department of Environment with us, and us going out to Ontario, but possibly just communicating and co-ordinating and seeing that you have the benefit of our methodology and so that you know when we are working on projects that do have provincial implications. It's possible in something like the dyking program, where it's 45% and 45%, where we could mount a joint team with one of your people and one of our people working together. The problem in that project is that it would also involve Quebec and British Columbia. Where we had the one team looking at the dyking program, inside flood control, inside the Department of the Environment, I guess we were well along in the work before we realized that we were going to look specifically at that one project inside Ontario. But yes, I think we should work together.

Mr. Scott: That is the purpose of it -- that where we do have cost-sharing projects, we could do it jointly. When you are looking at an Ontario agreement -- I'm thinking here of a project entered into by the Federal Government and the Province, and the project administration lies at the provincial level -- if we could pool our resources and have members from both our respective staffs doing the audit simultaneously, then we could come up with some sort of uniform replies and reports and I think we could utilize our resources much better.

Mr. Meyers: I agree. The problem is that we were auditing the systems inside the federal Department of Environment and we just happened to choose that example. So we were probably almost through our work before we realized that we would be getting into a little more depth in a specific project in the Province of Ontario.

* * *

Q. *Mrs. MacIvor:* One area in which I am interested, while you are talking about value for money and responsiveness, responsibility and accountability, is this: what about the political aspect? Where do you draw a line between what you are doing and where politics enter into it or intrude upon it?

Mr. Robinson: That is a question which is a continuing challenge to us. I think that the line we try to draw is that we're auditing the bureaucratic processes of government, so we want to see that the bureaucrats have done their work -- that they provide decision-makers with information which is reasonably complete and technically competent so that well-informed decisions can be made. From that point on we sign off; we are not interested in whether a cost-benefit analysis, for example, is absolutely followed to the letter. We are not going to demand that a minister must make only decisions that are, for instance, justified on an economic basis. You see it's really the mirror image of the effectiveness question; it's

whether you are looking at the question before the decision or after the decision. I would apply the same kind of guidelines to our work in looking at the approval process as we apply looking at the effectiveness process. We want to be sure that there are satisfactory procedures in place, that reasonable measurement has been done and has been duly reported. Thereafter that information is an input to a decision, and just one input; it's an analytical input. We're in a political process and there is a valid political input which we should not and must not deny. So as long as the analytical input has been taken care of, we're happy.

* * *

Q. *Mrs. MacIvor:* I'm not sure when you are looking at projects that have been finished or whether you are looking at projects that are just in the planning stage. One of the projects that you were talking about this afternoon involved looking at something before a final approval had been given and pointing out pitfalls and some of the problems which led to a delay or deferral. Doesn't that get into politics? It's pretty well passing judgment or making some sort of a statement about policy.

Mr. Almack: All we are really after is evidence that the Minister was provided with all the facts, sound data, a reasonable estimate; that the Minister, when he made the decision, made it in the full knowledge of those things that are available, that can be quantified. And if the benefit is something non-quantifiable -- an aesthetic thing -- then he should know that. He should know he is buying an aesthetic thing and he is not buying a phony benefit. We don't want him to get information quantified that can't be quantified. We want him to be able to make the political decision with all the benefits of good information and good knowledge.

* * *

Mrs. MacIvor: I've been sent a question here but I think we ought to let the Chairman ask it!

Q. *Mr. Rayner:* Why was Syl Cloutier, who spoke yesterday, so concerned about value-for-money auditing?

Mr. Almack: From what he said yesterday he was making the assumption, because he installed very fine systems (which he may or may not have; I have not examined them) that the systems are the answer. But if you read the Auditor General's Report he was very careful to point out that systems are only tools and these tools have to be matched with a dedicated pursuit of economy. Tools are not enough. And we would not accept, just because the tool is there, that economy and efficiency are going to naturally, automatically accrue. We want evidence that the tools are used and the results show due regard for economy.

* * *

Q. *Mr. Rogers:* Assuming that value-for-money auditing is appropriate where public funds are concerned, I would like to ask a question. When does public money cease to be public money? I am thinking in terms of transfers to Crown corporations, individuals and organizations where the ultimate deployment of that money is not under central control. Is value-for-money auditing not also applicable and appropriate in those circumstances?

Mr. Meyers: I think it is always applicable and appropriate where public money is concerned. It is your approach to it and your legislative right to access to information that can be questioned. In some cases where we are the auditors we could conceivably apply that mandate or we could suggest, as we have to the people drafting new legislation on Crown corporations, that they should include the value-for-money mandate or some equivalent, including comprehensive audit, in the actual legislation for Crown corporations. As long as you have control of the organization I think that applies.

As soon as you go beyond the control point, whether that's 50% interest or whatever, then access clearly becomes much more of a bind. There are, I think, program evaluation techniques you can probably use to find out whether or not the money was spent in such a way as to be effective in reaching your goals. It wouldn't be the responsibility of the auditor to do it himself but it would be his responsibility to see that the department that funded that program did have a system

Q. *Mr. Rogers:* Would you feel it would be the responsibility of the Auditor General to audit such a system, or report if the system did not exist in the funding department to carry out the function you just described, where the recipient corporation was not controlled or was any third party?

Mr. Meyers: Personally, I think it would be undesirable. We'd deploy too many resources. I think that since the funds have been provided by a department, it is the responsibility of the department to have an adequate control system. And part of that control system would be program evaluation. It could well be contract audit inside the third party organization. But our responsibility is to see that the department's system is adequate to ensure due regard for value for money.

* * *

Q. *Mr. Rogers:* If the value-for-money audit is applicable in the public sector, what is its applicability in the private sector, in that it is more indicative of where the failure is than 'the bottom line' we talk about?

Mr. Robinson: I think this question is one which is going to be dealt with by the auditing profession and people working close to that profession over the years ahead. My personal view on that is that corporations have mixed objectives. I think the idea that a corporation operates purely for an economic or profit objective is quite obsolete and I think Joe (San Miguel) will tell us that much of the writing that is done in schools such as his would reflect that. So I think there is a valid proposition that the 'softer' objectives of a corporation (corporate responsibility, protection of the environment and so on) are best assessed and measured by techniques which are highly similar to the techniques we would use in the public sector looking at the outcomes of government programs. I see an emerging and perhaps even an immediate application of the kind of techniques we are developing here in the private sector. I think it is going to take a while to see them incorporated but I think the opportunity is certainly there.

* * *

Q. *Dr. San Miguel:* Are we talking about a future opinion, rendered by the Auditor General, on a specific department that would deal with how management has performed with respect to economy, efficiency and effectiveness? Is there something then that would resemble, then, the opinion audit?

Mr. Robinson: Yes, absolutely. If there is an emerging initiative within the OAG, it is that we would like to see departments reporting on the discharge of their responsibilities, their managerial responsibilities for economy, efficiency and effectiveness, as well as the traditional accounting responsibility. We would be, I think, prepared to attest to the accuracy, completeness, reliability, credibility of that report. That puts us in the attest mode across this entire mandate and I think it would put government in a much stronger position advocating and, we hope, stating fairly the good things that it has done as well as the bad things that it has done. If its efficiency has gone up, that's noteworthy; we're more likely to say that they knew which way efficiency went.

I think a lot of the negative aspects of the audit mandate now arise because we find ourselves reporting on things that are material -- failures that departments have not reported on. Departments are not taking the initiative of reporting on those things which are equally valid, which are successes. So it looks like an unbalanced picture and departments tend to react negatively. I would like to see them much more proactive, going ahead and publishing the information, reviewing the information to Parliament, and to see us attesting to its accuracy and completeness.

Q. *Dr. San Miguel:* Continuing that thought -- because before lunch we were presented with the idea of reports to Parliament that would include non-financial measures of performance -- my question is this: if we have some attestation of management performance, and we're talking about non-financial performance indicators, who is going to decide what these indicators should consist of? Is this going to be the auditors? Management in the departments? Are we going to get directives from Parliament? How would this evolve?

Mr. Robinson: I think we have taken some first steps in that area by going public and publishing our audit criteria. I think this is something that represents a novel approach for a legislative auditor and it's one that we are quite enthusiastic about. In effect, what we are saying is "This is what you have to do to get the Auditor General off your back." I think it's the department's responsibility in the first instance to decide what it needs to discharge its managerial responsibility. I think that was a point being made by Mr. Cohen yesterday, where he has to allocate his time and his resources are limited and he is going to do what he thinks important. We have given him an input --- to say from our point of view: "We think you should be satisfying these criteria. You obviously have other things you have to do but this is our set of expectations."

Rather than asking him to drive up for a crap game with dice he's never seen, I think we are being quite fair about it, in allowing him to do pre-inspection, a scientific check of the dice to make sure that they are fair, square and they roll sevens the appropriate number of times. So it's the department's initial responsibility; it's ours to inspect as to the discharge of the managerial responsibility within the department.

* * *

Q. *Dr. San Miguel:* The U.S. Congress may ask the General Accounting Office to investigate performance in a particular agency. Has there been any specific request on the part of Parliament on specific performance information on departments, or is all of this really initiated by the Auditor General's Office?

Mr. Meyers: I think the Auditor General initiated it in the 1975 Report to Parliament. We commented on the adequacy of the information to Parliament and there are Public Accounts hearings on it. We recommended there be a study done by the Treasury Board and the Public Accounts Committee strongly supported that recommendation. When that wasn't done, we launched a project in 1977 to demonstrate that it could be done. That was what Glenn Ross was talking about yesterday -- Chapter 6 of this year's annual Report. We demonstrated that for a given department certain information on productivity could be put forward. We've also done it in some specific instances: the Public Accounts Committee asked us to demonstrate, for the St. Lawrence Seaway Corporation, that better information could come forward in the Estimates and we prepared a model that we expect to present to the Public Accounts Committee this year. We wouldn't be submitting information *per se*; we would be submitting a format and saying this information is available or it can be developed and you could use it this way. You would then have to be supported by the Public Accounts Committee and by Parliament. They would have to say this should be done; there would have to be some form of instruction or the Government would have to accept the recommendation. The best the auditor can do is to give an opinion on such data.

* * *

Q. *Mr. Scott:* Since it is going to take a considerable amount of training to integrate your value-for-money auditing with your normal auditing, is there any time frame or target date set by your Office to fully integrate this plan of auditing?

Mr. Meyers: We wouldn't necessarily mean, even if we've integrated, that the same person would be able to do all things required of a value-for-money audit. When we say integrate, we think of a comprehensive approach to a problem as opposed to the approach we have used in the past.

For example, in the SPICE study we had a group of industrial engineers go into a department and look at a productivity issue. When we say integrate we mean we have an audit principal, who has the responsibility for that government program, do a preliminary survey of the whole program, decide what audit work should be done and then think of what resources he requires to do it. We feel that for most of the value-for-money work that needs to be done, the state of the art is such that you can find the people with the training to do it. You can find skilled industrial engineers, you can find people skilled in program evaluation, you can find social scientists and you can find financial auditors. We think we can start right now and do it, but we can't do everything all at once.

At the same time we have to decide how much of the methodology can be taught to an audit generalist; at what point do you need a skilled industrial engineer, at what point can you train a young man to do it? I think Mr. Cloutier came back on this very well yesterday when he said: "I just don't see how you are going to teach people judgment. They've never sat behind a desk. How can they come in and judge me?" That certainly makes me nervous. He mentioned some of the levels of knowledge that he feels you need and he is right. We were criticizing the construction of icebreakers, for example, and he is saying: " You've got people who have never built a ship, understand very little about ship building and yet they are ready to go in and criticize the way we tackled that problem. There aren't a lot of icebreakers made in a year. Yes, we made an error in the estimate but maybe any normal person would." The approach we have to that kind of problem is to co-operate very much with the department and use the department's own expertise. In this case, to the extent that we exercised poor judgment, the Department of Transport was very ready to advise us and set us back on the straight and narrow.

* * *

Q. Mrs. *MacIvor:* Do you see some danger, in your whole novel approach, with the government's publicized intentions for restraint and spending? Do you see this as becoming a very easy excuse for not implementing some of the changes that you have been talking about?

Mr. Robinson: I think it's always a credible response from an organization that it can only accomplish so much in a certain time, given an atmosphere of restraint. I think we had a good run-down of some pertinent facts about Customs this morning. The first time I saw that presentation -- I didn't work on the Customs job myself -- I think I understood a lot more about the kinds of things I've been hearing from our Customs audit team. So I think we have to be fair-minded in the amount of and speed of response we can expect from these very large complex organizations. They don't turn around overnight.

To look at your question a little more directly, in terms of whether restraint as a response is in effect a way of copping-out on a constructive response to the recommendations -- I hope not. We tried to be quite rigorous with our own people and our own work in a couple of different ways. One is that we're always following the precedent of the other work in the Office. We've always wanted to produce a recommendation which we felt was credible and indicated the way in which resolution to a problem could be sought so that we are not left with dangling criticisms. In looking at those recommendations that we've considered putting in Reports, I hope we've been quite rigorous with ourselves saying: "Is this feasible? Are we being realistic about this? Could I, as a manager of that department, visualize accomplishing the kinds of recommendations that we're putting in there?" We're trying always to see the thing through the department's eyes and trying to recommend a position that would see the department better managed. We've thrown out numbers of audit observations and numbers of potential recommendations because we couldn't convince ourselves that that was really feasible or the right way to go.

One point I was trying to make in my presentation was the importance of the inspection of our work and the control over our own work to seriously question every position we take, because the Auditor General has a very powerful mandate. He speaks with a voice which has to be reckoned with in Ottawa. We have to be very responsible with the positions we are taking in this new area of value for money.

* * *

Q. *Mr. Rogers:* The very fine presentations that have been made today have sort of dispelled the questions that I had in my mind ahead of time but I am concerned in one area. The resources at the disposal of legislative auditors or that the legislative auditor has around his office are limited. Is there any fear of value-for-money auditing being developed to the detriment of FRAME? These are other aspects of auditing, especially the attest function, the evaluation of internal control and EDP auditing. In this latter area, EDP auditing, I feel that auditors generally run great risks of failing to discover conditions conducive to material fraud and error and I have a fear that resources that perhaps should be applied in that area will be diverted to value-for-money auditing. I wonder if you would like to comment on whether my fear is realistic or not?

Mr. Robinson: I think the question that J.-P. Boisclair addressed in his presentation of how one arrives at an audit -- a decision to look at a certain sub-set of all the questions you could consider -- I think that's the strategic decision for the auditor. It's one which warrants a good deal of attention and one that the Office is paying ever more attention to. Perhaps J.-P. could answer.

Mr. Boisclair: I'd like to answer in the context of the work that we did do at Customs, where we had to look at two things: one, the economy issues surrounding a computer system which cost upwards of $20-25 million to develop and put in place, and the other side of it being a system that's processing about $3 billion worth of transactions once it's up and running. We looked at it carefully and we did put an awful lot of weight on the ability of this system to prevent fraud or error and, in addition, its links with the other parts of the systems that the Department uses. It really took less time to come to grips with the economy issues, once we got rolling on it, than it did to cover off the financial control issues. We consciously had that in mind when we went ahead and placed the weight where we thought it would count.

* * *

Q. *Mr. Rogers:* How can you reconcile the attest audit, which is annual, with the cyclical approach to comprehensive auditing?

Mr. Boisclair: We aren't ignoring the annual aspect of the attest work in Customs. Having looked very hard and closely at the systems, we know where the areas of risk are; we know where our attest mandate lies. In our case it's a fairly narrow one, so it does mean that we'd be coming back every year to satisfy ourselves in the attest area but it would not be a large piece of work.

Mr. Rayner: My only supplementary comment would be to say that, as John Kelly made clear this morning, we do have the continuing annual responsibility of giving an opinion on the Public Accounts. That places an obligation on us to do a certain amount of basic audit work in all of our clients each year, so we are very carefully planning to go beyond that base requirement when we are doing the comprehensive audit. That we have to do on an extremely selective basis because of the complexity of the issues and the scales and magnitudes involved. The basic audit work required for an opinion on the Accounts and required to satisfy ourselves that government administrative policies are being adhered to is still built into the ongoing audit program. So we're not overlooking attest and authority or what people talk about as a traditional audit. We're simply adding to it and adding a dimension to the total audit service we're rendering to Parliament.

* * *

Q. *Dr. San Miguel:* Is there an implication, in the work that you're doing, that you will eventually be pre-auditing budgets or the Estimates and the capital proposals by the various departments? You are building up a body of expertise and are there any plans to then examine the assumptions that the various departments make in coming up with their projected performance measures?

Mr. Meyers: Not in quite the specific sense I think you mean it. We plan to audit the systems and organizations and procedures that lead to the planning process and eventually to the Estimates and on a test basis the integrity of the information. I don't see giving an opinion, on an annual basis, on the Estimates submitted to Parliament. I'd see more of a systems audit of the process that produces the Estimates for Parliament. We have already begun that this year with Glenn Ross' project that was looking maybe not at the integrity of the data but at the data itself. Is the data meaningful and adequate? Are the performance measurements you're getting adequate? Can you rely on the integrity of the figures they've given you as a performance measurement? We'd go on to test the integrity, later.

* * *

Q. *Mr. Scott:* Ken has gotten off very lightly today but he can answer this yes or no. Yesterday I listened to Mr. Cohen and I inferred from his discussion that there are programs or activities that possibly we shouldn't be into on a comprehensive auditing basis. I think he used the expression that he had a pocket full of money and he was willing to play craps and play at the proper crap table. What he didn't say was that that pocket full of money was your money and my money that he was going to play the game with. I wonder if, in your opinion, there are any programs or activities that should not be subject to comprehensive auditing?

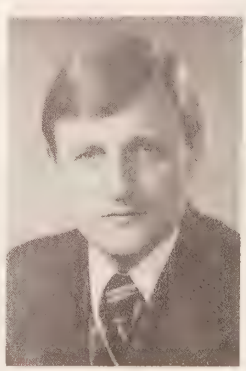
Mr. Belbeck: No.

* * *

Mr. Rayner thanked the participants.

Michael H. Rayner, C.A.

Michael Rayner is an Assistant Auditor General, with responsibility for Public Accounts, Planning, and Reports and Communications. As a staff member of the Treasury Board Secretariat Mr. Rayner was seconded in 1973 to the Independent Review Committee on the Office of the Auditor General of Canada (the Wilson Committee) as its Executive Secretary. In 1975 he joined the Office as Director General, Professional Practices and Development and has appointed to his present position in 1977.





Carol MacIvor

Carol MacIvor is a national parliamentary reporter for economic affairs, CBC Radio. A graduate of Boston University in linguistics, she was with Radio Canada International from 1972 to 1976. Carol MacIvor covers national economic affairs from an Ottawa viewpoint.



Douglas W. Rogers, C.A.

Bill Rogers is Auditor General of Alberta and a member of the Canadian Institute of Chartered Accountants' Study Group on Standards for Government Accounting, Reporting and Auditing. Earlier this year he was elected to the Council of the Institute of Chartered Accountants of Alberta. A member of the Canadian Information Processing Society, Mr. Rogers served on the C.I.C.A. Study Group (1968-1974) which developed *Computer Control Guidelines* and *Computer Audit Guidelines*.



Joseph G. San Miguel, Ph.D., C.P.A.

Joseph San Miguel is an Associate Professor of Business Administration in the Graduate School of Business Administration, Harvard University. In the past few years he has been engaged in research in comprehensive auditing and recently designed a new course on this subject for the MBA program. Professor San Miguel is currently conducting research on the internal audit function in large U.S. corporations.



F. Norman Scott, C.A.

Norm Scott is Provincial Auditor of Ontario. Following service in the RCAF, 1941-1945, he returned to financial administration in Ontario's Public Service, joining the Office of the Provincial Auditor in 1952. Mr. Scott was appointed Assistant Provincial Auditor in 1973 and Provincial Auditor in 1974. In 1975 he served as General Chairman of the Legislative Auditors' Conference in Quebec City.

Centennial Conference
Office of the Auditor General of Canada

SUMMARY OF REMARKS BY CONFERENCE CHAIRMAN

Ottawa, Canada
December 8, 1978

SUMMARY OF REMARKS BY CONFERENCE CHAIRMAN

James J. Macdonell

I hope you share with me the feeling that the time since the Conference was opened yesterday morning by Mr. Speaker has passed very quickly because of the excellence of the presentations and the stimulating discussions they have generated.

The program bills the topic of my concluding remarks as ASCAM which, as you know, stands for Advanced Studies in Comprehensive Auditing Methodology. I am sure it has been clear to all of us that comprehensive auditing as we have attempted to present it at this Conference is a complex subject. Parts of it are quite familiar but other parts, especially those relating to value-for-money auditing on a systematic basis, are new. The development of all the parts on a co-ordinated, integrated basis is a challenge to which we in the Audit Office are addressing ourselves with great vigour and enthusiasm. We hope we are making a potentially worthwhile contribution to the professional practice and methodology of public-sector auditing in Canada.

ASCAM

The ASCAM program comprises three separate but closely-connected projects. The first is the development of an audit manual embodying appropriate descriptive methodology for conducting comprehensive audits, using our FRAME concept to highlight the scope areas and skills needed:

F - financial controls
R - reporting to the shareholders (Parliament)
A - attest and authority
M - management controls
E - EDP controls

Some subjects to be covered by this manual are already well-advanced, particularly those relating to attest and authority. A good deal of work has also been done in the F area. The team that led the CAISE study is working hard on developing the E area. A good foundation has been laid for the R content through the work which has been reported in the Centennial Report to the House of Commons. The M area, however, is a big challenge and we are applying major professional resources to its development.

Project two is an instruction course on comprehensive auditing, starting on a top-down basis, for our own professional personnel. Ultimately we expect that this course, as it develops, can be made available to other interested governmental and professional groups nationally, and perhaps even internationally. The course is being designed with the help of academics to use the case method and is expected, in its ultimate form, to embrace both classroom instruction and hands-on, project-oriented experience.

Project three is the writing of a book tentatively entitled "Guidelines to Comprehensive Auditing as Developed and Applied in the Office of the Auditor General of Canada". Because of the generic nature of comprehensive auditing as we are defining it, and because of its wide applicability throughout the public sector, we think we should endeavour to capture and record the basic information and methodology that has been developed during the last five years in the Audit Office, and will be developed over the next year, in a more generalized fashion than is possible in an audit manual. What we have in mind is, in a sense, a companion volume to the *Guide on Financial Administration for Departments and Agencies of the Government of Canada* published some years ago by the Treasury Board of Canada. That book has proved to be a valuable addition to the literature on financial administration in governments. We are hopeful that the book on which we are presently engaged may occupy an equally useful place in the literature on public-sector auditing. As we all know, the literature on this subject is remarkably sparse in Canada, and indeed internationally, considering the great importance that now attaches to the financial involvement of governments in the lives of ordinary citizens in the Western world -- and the Eastern world, too, I suspect!

It has been part of my creed throughout my working life that when time is of the essence, as it usually is, it is better to do any intelligent thing quickly than to search hestitatingly for the ideal. Thus we have set a target date of the spring of 1980 for the task forces engaged on the ASCAM program. We fully appreciate that comprehensive auditing, as we are attempting to develop and apply it in the Audit Office, will be a process of continuous evolution over many years, as is the case in almost every professional endeavour. But we are determined that a start must be made if we are to discharge adequately our new mandate from Parliament.

I am delighted to report to this audience that on Wednesday of this week I met with my colleagues with counterpart responsibilities in each of the provinces of Canada to inform them of the progress that we have made on the ASCAM program since I introduced the subject at the annual meeting of Canada's legislative auditors held in Edmonton in September 1978. Three provinces already have in place value-for-money auditing legislation similar to that incorporated in the 1977 federal Auditor General Act. We understand that several other provinces are considering adopting similar legislation. It was agreed at our meeting on December 6 that we should establish a co-ordinating committee so that we can share our professional knowledge and experiences in the development of comprehensive auditing. We agreed that each of us should put into the pool everything that we have on the subject and withdraw from the pool whatever we

need and can use for our individual purposes. This concept recognizes that from the standpoint of our shareholders, the taxpayers of Canada, we must ourselves do everything possible to ensure that our professional activities for our legislative bodies are carried out with maximum concern for economy, efficiency and effectiveness. In short, we must not re-invent the wheel at the expense of the taxpayers.

Managing Public Funds and Resources

During the course of the various sessions at this Conference, some references have been made -- particularly during the two question periods -- to certain items that might appropriately be discussed in my concluding remarks. Time really does not permit me to deal with these because the hour grows late and I am sure many have planes and trains to catch. Possibly the interesting session yesterday afternoon, which dealt with the management of public funds and resources, deserves a brief comment from me.

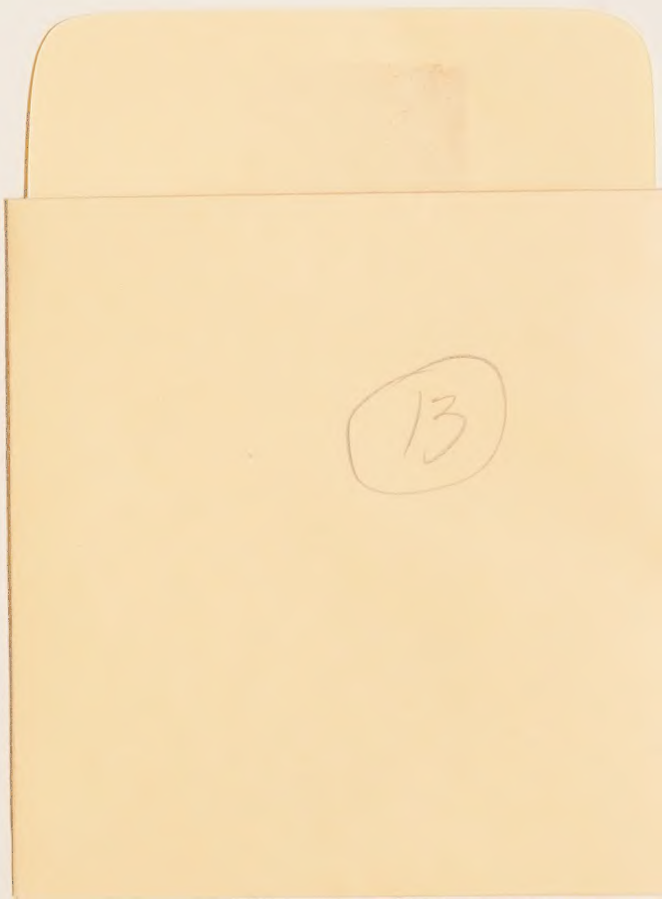
I believe that one of the themes that Messrs. Cloutier and Cohen dealt with was the uncertainty about the implications of our new value-for-money auditing mandate for managers in the Public Service. I think there was a sort of plaintive plea, that indeed it would be nice if we could get back to so-called traditional auditing and leave managers alone as much as possible, so they could get on with their job of delivering programs.

I can be somewhat -- but not very -- sympathetic about the disturbing effect that a concept such as accountability on a value-for-money basis may be having on some managers in the Public Service who have not been required heretofore to think in these terms. But, sympathetic or not, I think they, and all of us in public service, must face up to the fact that not only is public-sector auditing changing but the management of public funds and resources must change too. There is a new mood in the country, of which I think most of us in public service are now becoming more and more clearly aware. It was well expressed by the Prime Minister in his address on August 1, 1978 when he said the responsibility of governments now is to deliver more for less. To the extent that we auditors can be helpful to management in achieving this goal -- and I know we can -- that must certainly be our desire and should surely be our role. The hard fact is that a new dimension is being forged in terms of value-for-money accountability for both managers and auditors in the public sector and the sooner we recognize it and adapt to it with vigour and enthusiasm, the better satisfied will be the shareholders (the taxpayers) and their representatives (the legislators).

I should like to conclude these remarks by venturing the thought to all here that it is a great occasion for professional people to feel in their hearts that they are doing something significant to expand the horizons and the common body of knowledge of their own profession. I think those of us who are engaged now in the developments that have been the theme of this Conference for the past two days, and the heart and core of our activities in the Audit Office for the last five years, share a feeling of achievement -- and excitement -- that we are contributing to the enrichment of our profession.

Thank you for coming. I hope you are glad you did.

6239


13

3 1761 11550373 2